THE
INDIAN MONEY MARKET

into a firm, well-knit, and yet flexible whole for the free creation, expansion and movement of credit, will demand a good deal of economic thinking in the near future With this is also implicated the problem of establishment of a Reserve Bank on sound lines That the management of currency and credit will have to be unified in India to prevent the inelasticity and instability of the monetary conditions is now accepted as one of the important financial tasks of the new constitution In what measure the type of Reserve Bank that is going to be established in this country will be able to achieve this purpose is not, however, certain Then there is the question of unsettling the ratio, of devaluation, whose effects will be different on different regions and sections of the community Divergent and even antagonistic agricultural and industrial interests will have to be co ordinated in order that the new constitution may fashion a financial policy, which instead of introducing a battle of the provinces lays the stable economic foundations of a Federal India Professor Sharma's book will serve the valuable purpose of focussing attention to these and other insistent problems in which the acumen and judgment of the Indian economist must have to lead India along the right road It rightly insists upon planned money, capital and credit as India's urgent and basal needs, and the sooner this is recognised the better

RADHA KAMAL MUKERJEE

UNIVERSITY OF LUCKNOW,

August 1934

PREFACE

An attempt has been made in this book to discuss the theoretical basis of the monetary operations in organized markets with special reference to conditions in India Indeed, my aim has throughout been to convey to the reader a vivid impression of the actual working and the interdependence of the various constituents of the Indian Money Market The work is intended to serve as a text-book on the subject and so special attention has been paid to the requirements of the B A and B Com Pass and Honours courses of Indian Universities and it should also prove useful to students preparing for the Masters of Arts Degree in Economics and Commerce I hope, however, that the book will also be found useful by businessmen and publicists who want to have a realistic idea of the Indian Money Market

So far as I am aware there is no single volume on the market dealing with the whole subject I have tried to be comprehensive and up-to-date within my limited compass, and for this reason topics like the Reserve Bank of India, the Imperial Bank of India Amendment Act of 1934, and the History of Indian Currency and Exchange after 1931 have been dealt with in the following pages in their proper places I have tried to take a judicial view of controversial topics such as those connected with the Reserve Bank, the Ratio, etc , and have given both sides of these great questions I have throughout taken special care to see that my own view-point should in no way obscure other views, particularly those of our leading business and financial interests Wherever necessary, comparisons and contrasts with the London Money Market have been instituted to bring out clearly conditions in our own country When facts and figures, not in common knowledge, have been cited, my sources of information have been duly given I also hope that the care spent on the index will enhance the usefulness of the book

While the book has been written for students and the general reader interested in monetary questions, I hope it is not altogether undeserving of the attention of specialists Informed criticism will, however, be welcomed from all quarters for the improvement of subsequent editions

My very special thanks are due to Prof R K Mukerjee of the Lucknow University for constant guidance and encouragement throughout the preparation of the book, and for his learned Foreword to it Indeed, the work has gained immensely by his valuable suggestions regarding the arrangement of chapters and other matters I am also indebted to my

honoured colleagues, Professor K S Bhatnagar M A and Dr H D Sharma M A, Ph D, for valuable help in preparing the book for the Press I am also obliged to the Editors of the *Mysore Economic Journal* and the *Commerce* for permission to reproduce a few chapters which have appeared previously in their esteemed Journals

K K SHARMA

CHAPTER I

Introduction

The development of trade, commerce and industry depends upon a well-organized money market The industrial progress of a country is determined by the availability of adequate finance The introduction of division of labour is very advantageous for industries, and as Adam Smith pointed out, the progress of division of labour in industries is limited by the amount of capital available The present industrial position of England, America and other Western countries has been achieved to a very great extent by the development of well-organized money and capital markets Modern industrial structure and organization have become very complex and necessitate highly-developed money markets They have been facilitated by and in turn have facilitated the growth of highly-organized money markets

Credit plays a very fundamental part in the scheme of industrial production Businesses cannot be carried on on a cash basis alone and credit has become highly indispensable A highly-developed and organized credit system is possible only in a well-developed money market

The term market is used in two senses firstly, it indicates a place where buyers and sellers of a commodity assemble to transact business and secondly, it also refers to all the operations connected with a particular commodity Money market, therefore, means all the operations which centre around the commodity money Thus it refers to those institutions which deal in the borrowing and lending of money Such institutions are banks of various kinds, discount houses and individuals who deal in the operations connected with money

The main function of the money market is to supply the producers with the necessary amount of cash and credit for transacting business There are people who save money, but they cannot use it in business There are others who possess the necessary business acumen, skill and talent but lack in money Both these classes of persons are brought into touch with one another by the help of a well-organized money market It attracts capital from those persons or institutions which save it and puts it into the hands of those who are able to make a good use of it In Western countries which are industrially well-developed, another function of the money market is the supply of efficient currency so as to secure the

relative stability in the purchasing power of money or in the level of prices This latter function is not clearly grasped by people and by those in charge of the credit policy of a country This lack of understanding of a proper regulation of efficient currency has been the main cause of the currency disturbances which modern society knows to its cost There can be no greater service rendered to the cause of economic stability than to understand and explain the forces governing the supply of an efficient system of currency and credit in a country By a wrong credit and currency policy the whole mechanism of the money market is disorganized and the result is a very great set-back to business and production

Credit plays a very important part in money markets The most important elements of credit are confidence, amount and time Credit system implies the transfer of goods from one person to another, the payment for which may be post-poned to be made in future, and it also indicates the loan of money for a certain period of time The most important media of credit are bank notes, Government promissory notes, bills of exchange, cheques, promissory notes of individuals, Hundis, etc A study of the money market of a country involves the study of all the operations connected with the creation and supply of such credit instruments

The main functions of credit are to save the use of metallic money, to finance the producer who is engaged in the production of goods in anticipation of demand, to permit the collection of a multitude of small amounts into banks and to minimise price fluctuations All these operations are essentially connected with the organization of money markets

A well developed credit system and money market are complementary "A fully co ordinated system of credit possessing different types of complementary institutions can never exist without its indispensable concomitant a well-developed and reasonably planned money market The development of the one leads to the perfection of the other and *vice versa* The money market is the groundwork of the country's national finance whose main flexibility depends on a fine division of labour and capacity for adjustment to changing conditions of society "[1]

The Indian money market is not as developed as the money markets in Western countries This is a very great handicap to Indian trade, commerce and industries The amount of capital available is not adequate to satisfy all the demands and resort is had to borrowing money from the London money market which is the international financial

[1] Rau *Present Day Banking in India* pp 1–2

centre The credit system is not as specialized by the development of perfectly organized institutions as in Western countries or in Japan Very few systematic attempts have so far been made to develop the money power of the country by banking institutions and hoarding still holds the field to a considerable extent The existing credit system lacks in elasticity and therefore, banking credit cannot expand to meet the extra demand for seasonal currency The Indian banks have no power to issue notes and owing to their low cash resources, their capacity to create other forms of credit is very limited Cheque habit is not well-developed and there is the absence of close connection between the European section of the organized money market and the native section of it The Imperial Bank does not and cannot control credit policy fully well This is done by the Government which is the currency authority in this country Provision is made for the issue of emergency currency to expand it in response to business needs, but this facility is not taken advantage of by the market owing to the lack of a bill market The Government maintains a few treasuries of its own to carry out its financial operations throughout the country The result is that large funds can be withdrawn from the market at certain times when they may be required there High money rates prevail and it is very necessary that such idle funds as lie in Government treasuries should be put into the hands of the bankers so that money rates may be low enough to facilitate businesses

Industrial banking facilities do not exist in India to meet the needs of the situation to an adequate extent Specialized institutions to finance industries do not exist and the existing joint-stock banks have not been able to provide the necessary amount of finance for the industrial development of the country Share and security markets do not exist to an adequate extent The result is that the debenture form of investment plays a very little part in the financing of industries Our foreign trade is largely financed through foreign banks and in this respect the Indian money market offers a striking contrast to the money markets in, say, England and America The bill market is practically insignificant

There is little co-operation and co-ordination in the various constituents of the Indian money market The shroffs and money-lenders seldom seek the help of the joint-stock banks and the latter do not seem to have enough confidence in the Imperial Bank so as to be able to seek resort to it in cases of emergency

The money-lender still controls the supply of agricultural capital and co-operative institutions have not been able to

cope with the situation and have not been able to reduce interest rates and to meet the needs of the cultivators on any extensive scale Land mortgage banking facilities are very inadequate to meet the needs of land owners in rural areas

It is a great redeeming feature that a Reserve Bank is soon to start operations in the country which should take India along the right path of her economic development The defects of the Indian money market and of the currency system will to a great extent be removed As a matter of fact the establishment and sound working of a centralized banking institution to serve as a bankers' bank and to control the currency and monetary policy of India is long overdue Of course, much will depend upon the degree of latitude granted to the authorities of the Bank to regulate the currency policy of the country If it is a truly national institution like the central banks of Western countries, it should go a long way to promote the economic development of the country by removing the existing grave defects of the Indian money market

The object of this book is to make a critical study of the Indian money and capital market and of the various constituents thereof An attempt is also made to offer suitable suggestions for improvement

CHAPTER II

Presidency Banks

The money market and the banking system of India consist of the following constituents —

(1) The Imperial Bank of India which came into existence in 1921 by the amalgamation of the three Presidency Banks ,

(2) The European Exchange Banks ,

(3) The Indian Joint Stock Banks ,

(4) The indigenous bankers known by various names —the Shroffs, Marwaris, Chetties and other private bankers and money-lenders , and

(5) The Agricultural Banks consisting of the Primary and Secondary Co-operative Credit Societies, Land Mortgage Banks, Post Office Savings Banks, etc. It is mainly from the above that the supply of money comes to the market, and they are the principal lenders of money

The borrowers of money are (1) the Government of India, who annually float rupee loans (2) the local and provincial governments (3) the agriculturists who resort chiefly to the agricultural banks and money-lenders for obtaining money , (4) the traders manufacturers and other small and large-scale entrepreneurs who get money from all these various agencies on their personal security and the security of Hundis Bills of Exchange, Plant and Machinery, etc

Our main business in the following pages will be to study the money market conditions in India by studying the above types of banking institutions and to suggest the main lines of improvement for the proper and adequate supply and organization of money and credit in the light of the existing shortcomings

The Presidency Banks

Chronologically banking in India is as old as our trade, industry and commerce Ample evidence exists to show that in the Hindu and Mohammadan times banking facilities suited to the prevailing economic conditions were in existence and the use of Hundis was made on a very extensive scale At present it may be mentioned that banking of the modern European type carried on on joint-stock principle did not come into existence till the advent of the Europeans

When the Europeans came into India, they established agency houses which generally added a banking branch to their main trading business Many such banking institutions came into existence in the 18th century One such institution was started by Messrs Hamilton & Co in 1770 which was known by the name of the Bank of Hindostan A second was started in the eighties of the 18th century known as the Bengal Bank, and later, a third was also started known as the General Bank of India on a limited liability basis with a capital of Rs 20 lakhs divided into 100 shares Some of these banks issued notes also, but their main function was to finance foreign trade carried on by the European agency houses All such institutions came to grief and sooner or later closed their doors owing to lack of proper organizing and managing ability on the part of their directorate Their prosperity lay in the particular number of business firms whom they financed

Later on, as the foreign trade of India increased, the necessity of sound banking facilities grew more and more The result was the introduction of three semi government institutions which till 1921 served as the main pillars of the Indian banking system The Presidency Bank of Bengal came into existence in 1806 under the name of the "Bank of Calcutta" with a capital of Rs 50,00,000 divided into 500 shares of Rs 10 000 each It received its Charter of Incorporation in 1809 under the name of the Presidency Bank of Bengal The East India Company contributed about one fifth of the share capital and appointed three of the directors Till 1857 the Treasurer and the Secretary were civilians of the Government of India The Charter of the Bank was modelled on that of the Bank of England's Charter of 1691 According to its Charter of 1809 it could not lend more than one lakh of rupees to any one individual and more than five lakhs to the Government, it could not raise its rate above 12 per cent and had to keep a cash reserve amounting to one-third of its outstanding demand liabilities and its total demand liabilities including deposits and notes could not exceed Rs 50 lakhs which was its capital Its Charter was renewed in 1823 and it could issue notes up to Rs 2 crores and the proportion of cash to its demand liabilities was reduced from $\frac{1}{3}$ to $\frac{1}{4}$ It passed through troublous years from 1830 to 1834 when its shares fell from a premium of Rs 6,000 to one of Rs 500 and even came to par But it survived its bad years owing to Government direction and vigilance

The Bank of Bombay was started in 1843 with a capital of Rs 52 lakhs divided into 5 200 shares of Rs 1,000 each The East India Company contributed Rs 3 lakhs towards its share capital and nominated three directors on the Board It was modelled on the lines of the Bank of Bengal It failed

in 1868 owing to mismanagement, lack of sufficient experience, the abuse of powers by unprincipled secretaries, lack of sound legal advice and because of the fact that it transacted business of an unsafe character

The New Bank of Bombay was started in 1870 and changed its name in 1876 From that time onward till its amalgamation with the other two Presidency Banks it worked successfully and paid good dividends to its shareholders

The Bank of Madras was started in 1843 and its Charter was closely modelled on that of the Bank of Bengal Its original capital was Rs 30 lakhs and the share of the East India Company was Rs 3 lakhs Its average note circulation before 1861 was Rs 15 to 16 lakhs It rendered immense service in popularising banking business in the Madras Presidency

All the three Presidency Banks had certain common features Firstly, they were semi-governmental institutions and as we have seen above, the Government had some share in the capital of all the three Presidency Banks and appointed some members of their directorate After 1876 they became purely private banks and in that year the Government gave up its right to nominate men on their directorate and sold off its shares It also withdrew the concession of placing at their disposal its funds free of interest which was the case up to 1876 in which year the Government established its treasury system

Another similarity was that certain restrictions were common to all of them There were some very rigorous restrictions as to the business they might carry on The principal restrictions were —

(*a*) They could not deal in foreign exchange business and they could not draw, discount purchase or sell bills of exchange except those payable in India or Ceylon It was due to the fact that foreign exchange business prior to the adoption of the gold exchange standard was very risky and it was thought proper in the interests of their safety to prohibit them from carrying on this business

(*b*) They could not raise funds outside India

(*c*) They were not allowed to make loans for a period longer than six months

(*d*) They were not allowed to advance loans on the security of immovable property in any manner nor upon promissory notes unless they bore the endorsements of two independent names

(*e*) They could not give loans upon the security of goods unless either the goods themselves or titles to them were deposited with the banks as security

These restrictions added to the safety of these banks and it was this cautiousness which was responsible for their survival at a time when India was faced by severe banking crises Had these semi governmental institutions failed, there would have been a great set back to Indian banking Their main functions were to receive deposits in India and to grant loans for a period not exceeding six months on the security of at least two independent names This left a certain loophole, because any two independent names appearing on the commercial paper could satisfy the letter of the law and the banks, of course, by satisfying the letter of the law proceeded within limits of prudence They financed the internal trade of India and could lend money on the security of goods provided the goods or their titles were deposited with them They also managed the debt of the Government of India and they were paid for undertaking this business They also issued notes prior to 1862, but this business of theirs was not very important and profitable from their point of view, because there were restrictions in that they had to keep a cash reserve of ⅓ formerly which was later on reduced to ¼ of their total demand liabilities

The note-issuing function was taken away from them by the Government of India in 1862 from which time onward the Government has been doing that business. Even under the regime of the Presidency Banks when they were allowed to issue notes, the supply of notes was not elastic owing to the restrictions mentioned above As a compensation for taking over the note issuing business from them, the Government placed at their disposal all their cash balances free of any charge This the Government went on doing till 1876—the year in which the independent treasury system was established by them The banks put obstacles in the way of the Government when the latter wanted to withdraw their funds for disbursements on various items As a consequence the Government established its own treasury system at the three presidency towns

In 1876, however, the Government agreed to keep a certain minimum balance with the banks free of any charge and to pay interest in case the balances kept were less than the legal minimum But no occasion arose to pay any interest because the balances held were always more than the legal minimum

The banks, however, wanted the Government to allow them to raise funds in London and bring them to India, for by this they could take advantage of getting it cheaper in England at about 3 per cent and investing it in India at higher rates and thus they could make a profit The Government, however, did not permit them to do so Mr Keynes also was not in favour of this because he showed that they could not employ

these funds during the slack season. Until the funds could be employed all throughout the year, there could be little advantage to the banks of this process being permitted to them. Mr. Keynes, therefore, suggested that the banks should either get loans from the cash balances of the Government of India or from the paper currency reserve. But this was no new thing and as a matter of practice loans were allowed to them, the policy of the Government being to allow loans to them at their published rates of discount.

This did not encourage the banks to get loans from the Government, for they could not get any profits in this way. The Chamberlain Commission suggested that they should be allowed loans at 1 per cent. less than their discount rate, but the Secretary of State did not accept the suggestion. The Government, however, placed large funds at the disposal of these banks during the war to facilitate the public to make investments in the war loans.

The Reserve Treasury system was very disadvantageous because during the busy season demand for money increased, but it was the time for paying land revenue. Therefore, at a time when funds were largely required in the market, a lot of them went to the government treasuries. This brought loss to cultivators, etc., for they had to sell when prices were being depressed owing to sudden withdrawal of funds from the market. The independent treasury system was, however, abolished in 1921 and no more comment need be made on it.

The above restrictions, however, did not prevent the Presidency Banks from making progress. On the other hand, they were helpful in letting them through severe crises very safely, though in those times other banking institutions came to grief and had to close their doors. Lately, however, when foreign exchange business had ceased to be speculative with the adoption of the gold exchange standard, there was little justification for these restrictions.

These banks were also very helpful in making the note circulation popular by providing special facilities for their encashment at their branches.

The following statistics show their position till their amalgamation into the Imperial Bank of India:—

BANK OF BENGAL

(*Figures in Lakhs of Rupees.*)

Year	Capital	Reserve	Govt Deposits	Other Deposits	Cash	Investments	Dividend per cent
1895	200	68	185	677	422	132	10
1900	200	103	155	582	243	136	11
1905	200	110	167	1,204	396	181	12
1906	200	150	160	1,505	528	149	12
1907	200	157	187	1,573	460	279	12
1908	200	165	178	1,575	507	349	13
1909	200	170	168	1,760	615	411	14
1910	200	175	198	1,609	514	368	14
1911	200	180	270	1,677	729	321	14
1912	200	185	234	1,711	665	310	14
1913	200	191	301	1,824	840	319	14
1914	200	200	287	2,160	1,169	621	16
1915	200	204	265	1,978	785	793	16
1916	200	213	274	2,143	772	768	16
1917	200	221	448	2,934	1,482	773	17
1918	200	189	554	2,392	894	779	17
1919	200	200	105	3,254	997	864	17
1920	200	210	434	3,398	221	910	19½

BANK OF BOMBAY

(*Figures in Lakhs of Rupees.*)

Year	Capital	Reserve	Govt Deposits	Other Deposits	Cash	Investments	Dividend per cent
1895	100	57	76	358	228	105	11
1900	100	70	87	432	129	89	11
1905	100	87	92	676	259	158	12
1906	100	92	101	832	351	177	12
1907	100	96	112	821	324	164	13
1908	100	101	94	832	377	149	13
1909	100	103	120	1,035	415	163	13
1910	100	105	152	1,053	436	149	14
1911	100	106	107	1,104	463	208	14
1912	100	106	117	1,124	315	210	14
1913	100	106	200	1,015	477	232	14
1914	100	110	183	1,081	646	202	15
1915	100	100	136	1,079	423	276	15
1916	100	90	142	1,367	667	312	15
1917	100	92	235	2,817	1,398	744	17½
1918	100	101	177	1,749	542	353	18½
1919	100	110	262	2,756	928	315	19½
1920	100	120	349	2,748	876	298	22

BANK OF MADRAS

(*Figures in Lakhs of Rupees*)

Year	Capital	Reserve	Govt Deposits	Other Deposits	Cash	Invest ments	Dividend per cent
1895	50	16	45	278	144	45	10
1900	60	22	35	260	82	67	8
1905	60	30	41	344	140	71	10
1906	60	32	54	353	151	81	10
1907	60	36	35	416	162	84	10
1908	60	40	52	447	153	84	11
1909	60	44	49	500	181	79	12
1910	60	48	72	567	184	85	12
1911	60	52	59	625	185	104	12
1912	75	70	75	743	196	113	12
1913	75	73	86	805	219	117	12
1914	75	76	91	761	267	134	12
1915	75	65	86	803	256	184	12
1916	75	55	104	960	286	161	12
1917	75	50	87	1,020	496	94	12
1918	75	50	102	954	271	139	12
1919	75	45	104	1,215	436	175	12
1920	75	45	118	1,579	505	211	18

Figures are taken from the *Indian Year Book*, 1929

As the tables show the Bank of Bengal was the best from the point of view of financial standing followed by the Bank of Bombay and the Bank of Madras respectively The capital of these banks does not show any increase except in the case of the Bank of Madras where the change is slight During the war time there was a great increase in the amount of the private deposits because of high profits reaped by the people owing to rising prices Their cash reserves were much above 30 per cent of their demand liabilities and their progress is proved beyond doubt by the increase in investments and the increasing rate of dividend declared, though in the case of the Bank of Madras there was a uniform rate of dividend from 1909 till 1919

CHAPTER III

Commercial Banking

COMMERCIAL banking in India is carried on by the Imperial Bank of India, the foreign exchange banks, the indigenous bankers and the Indian joint stock banks registered under the Indian Companies Act There is no clear cut demarcation of functions of these various classes of banks in India, because the Indian joint stock banks do handle bills relating to export and import trade of India and the foreign exchange banks deal not only with foreign trade but with every branch of what has been called commercial banking and they have also been known to give cash credits and overdrafts to industrial concerns on adequate security

There is no law prohibiting a bank from carrying on a particular kind of business that it is permitted to do by its Articles of Association and its Memorandum Nonetheless these various classes of banks have specialized in various types of banking and hence the justification for this classification In India as in almost all other countries of the world commercial banks mostly deal in the distribution of credit and they are deprived of the right of note issue This function is performed by the State in India and by Central Banks in foreign countries They attract deposits from the public usually for short periods of time and supplement these resources by obtaining loans against their investments of various categories The money is lent out to traders and businessmen for short periods Thus these banks render a most useful service to the economic life of the community by mobilizing the banking resources and making them available for profitable channels of trade and commerce [1]

---

[1] "Before the war, the general policy and the chief activities of the commercial banks differed appreciably from country to country In the Anglo Saxon, Scandinavian and Latin-American countries the banks devoted themselves to what has been described as 'deposit banking'—*i e*, to receiving money on deposit and lending it on short-term to commerce and industry in the form of discounts and advances, normally they avoided immobilising their resources in long term credits to, or participations in, industrial enterprises In these countries, the banks did not as a rule exercise any direct influence on the management of the business undertakings which were their customers The banks in Continental European countries, on the other hand, largely specialised in 'investment' or industrial' banking As a rule, they maintained close relations with industry and often took the initiative in creating new industries whose shares and bonds they subsequently placed with the general public Frequently, they maintained a substantial proportion of these securities in their own investment portfolio, an appreciable proportion even of their short-term

Distribution of Commercial Credit

The advances given by commercial banks fall under three classes (1) Advances against marketable security pledged with the bank , (2) Clean advances against personal credit with a second signature to the promissory note , and (3) Clean advances against the personal credit of the borrower only In India the first two types of advances are most common as against that of the third type in Western countries

---

deposits was normally extended in the form of long-term working credits to concerns under their control They were generally directly represented on the boards of the more important undertakings financed by them Their general liquidity was largely dependent upon the financial position of a comparatively small number of important customers On the other hand this policy resulted in a very active support to industry, particularly for the opening up of new fields of activity, in countries where capital was comparatively scarce

This description of banking conditions on the European continent applies particularly to Germany, the old Austro Hungarian Empire, Italy, Belgium and, to a less extent, to the Netherlands In France the banques d'affaires and the important private banking houses carried on business along similar lines , the leading banques de credits operated chiefly as deposit banks and, in addition, played an important role as intermediaries for the issue of Government and other public loans, both domestic and foreign—a form of investment which was particularly attractive to French capitalists The big commercial banks in Switzerland, which, however, were of less predominant importance than those of the other countries, also undertook industrial banking on a large scale, but owing to the early establishment of special trust companies acting as intermediaries between the banks and industry the direct relations of the banks with industry were less intimate

Austro-Hungarian and German banking practices were also adopted in most smaller Eastern European States After the war the Succession States created new banking systems on the basis of the old local banks and the branches of the Vienna, Budapest and Berlin institutions These systems have, on the whole, continued the pre-war traditions

In post-war Europe, the contrast between pure deposit banking and industrial banking systems has been considerably weakened The systems of the former type have extended their operations over a considerably wider range of activities and have entered into much closer relations with industry than formerly This is partly the result of the first post-war depression which seriously affected many of their most important customers , short-term credits became frozen and, to protect their own interests, the banks were frequently obliged to take over the security for loans previously granted and to assume direct control over large industrial undertakings The direct relationship thus established between banks and industry enabled the former to exercise an active influence on the reorganization of the latter The gradual liquidation of the banks' industrial engagements proceeded relatively slowly and had been only partly effected when the present depression set in Furthermore, in some of the countries concerned, issues of industrial shares and bonds especially those of older industries have been less easily marketed in the past decade than formerly, industry, accordingly, has had to rely upon bank credits to a greater extent

The bulk of credit is granted against tangible assets as bonds, shares and immovable property because the quantity of two name paper acceptable to banks is limited The most favourite method of borrowing is the cash credit system under which an advance is granted by the bank against a promissory note of the borrower and secured by hypothecation of stocks According to the system the borrower has to pay interest to the extent to which he avails of the credit from day to day The bank can withdraw the facilities at any time, if necessary, and the borrower can also similarly reduce the obligation subject to a minimum interest clause according to which the bank would charge interest on a minimum amount usually half the maximum limit of the drawing power allowed to the borrower The system of cash credit stands in the way of the popularity of the bills of exchange

The main reason for the difference in the practice in Western countries and India is the tradition established by the various classes of banks reinforced by the provisions of the Indian Companies Act requiring the classification of a bank's advances in the balance sheet as secured and unsecured Other reasons are —

(1) Absence of touch between borrowers and lenders in the money market,

(2) Absence of the policy of "one man one bank"

(3) The managing agency system,

On the European continent, on the other hand, even the big banks are not devoting more attention to deposit banking than formerly Their holdings of shares in industrial undertakings have been reduced not only in proportion to total assets but in many cases, even in absolute amount since before the war and their methods for long term financing of industry have been substantially modified The risks involved in immobilising a large proportion of short-term funds in long term credits became very patent during the difficult periods of shaken confidence through which most countries passed after the war Through financial, trust or holding companies operating chiefly with funds raised by issue of debentures the banks can exercise an influence on industrial concerns without becoming too closely identified with them Such companies have experienced a marked development in recent years, both in the countries where industrial banking is the most characteristic and in those where deposit banking still predominates

Even though the contrast between the two main types of banking with regard to their relationship to industry has thus become less marked, there are still many significant distinctions between them, since the characteristics of the banks vary from country to country A striking feature in post-war banking particularly in Germany and Poland, is the very rapid development and great importance of public banks (*i e*, credit institutions belonging to or controlled by governments and other public bodies) which carry on all forms of deposit and industrial banking" (*Commercial Banks*, 1913 1929, League of Nations, 1931 Edition, pages 13–14)

(4) The absence of institutions which can supply information to bankers about traders and businessmen.

The Indian Banking Committee write, "We consider that banks in India generally should adopt, as far as possible and consistently with safety, a more progressive policy in the matter of granting clean advances on the personal credit of borrowers. In our opinion the change will be facilitated by the growth of the practice 'one man, one bank'."[2]

Clean loans against personal credit of the borrower of good character are as safe as any other. Collateral security is liked by the banker on the principle that there is strength in number but in case of bazaar discounts, the banker looks to the endorser who has presented the bill to the banker and not to the original drawer. Therefore, a two-name paper is in practice against the security of the individual borrower. In a large number of cases the basis of credit is the banker's confidence in the individual customer and this confidence depends upon the fact that the banker knows the borrower's personal standing, integrity and ability to liquidate the paper on the due date. In large-scale enterprises the banker cannot be expected to know personally the character and financial standing of borrowers and he must, therefore, supplement his general knowledge by information through other sources. In England and America, Seyd's and Dun's respectively, are the agencies to give information regarding the individual borrowers and such agencies should be developed in India also. At present individual banks in India maintain separate and individual establishments for getting information about their customers. The Indian Banking Committee recommend "that the problem of pooling the information and organizing some system of collecting reliable information, a system suited to the needs of Indian customers and conforming, as much as possible, to Indian custom, should be studied by the banks and the bankers' association proposed by us." (Pages 383, 384 of the Report.)

At present an important source of getting credit information by banks is the balance-sheet supplied by the borrower directly on enquiry. To suggest that the Indian borrower is not as willing to divulge the information freely as the borrower in Western countries will be unjust and the Indian Banking Committee in this connection write that in a great majority of cases such information is easily available provided a correct method of obtaining it is followed. If the bankers maintain a proper touch with their borrowers, they have no difficulty in getting such information.[3]

[2] *Indian Central Banking Committee's Report*, pp. 382, 383.
[3] *Ibid.*, p. 384.

Another way to get credit information is the interchange of information, experience and personal knowledge of the various banks regarding their customers

Capital, Reserve, Deposits and Cash Balances of the Principal Indian Joint-Stock Banks on 31st December, each year[4]

CLASS A —*Banks with Capital and Reserve of Rs 5 lakhs and over*

(*Figures in Thousands of Rupees*)

Year	No of Reporting Banks	Paid up Capital	Reserve and Rest	Total	Deposits	Cash Balances
1870	2	9,83	1,82	11,65	13,95	5,07
1880	3	18,00	3,11	21,11	63,37	16,63
1890	5	33,56	17,59	51,09	2,70,78	55,79
1900	9	82,12	45,60	1,27,72	8,07,52	1,19,01
1905	9	84,57	77,82	1,62,39	11,98,92	1,73,50
1910	16	2,75,66	1,00,55	3,76,21	25,65,85	2,90,25
1915	20	2,81,39	1,56,65	4,38,04	17,87,27	3,99,41
1916	20	2,87,36	1,73,66	4,61,02	21,71,05	6,03,19
1917	18	3,03,70	1,62,99	4,66,69	31,17,01	7,64,81
1918	19	4,36,45	1,65,59	6,02,04	40,59,18	9,48,75
1919	18	5,39,67	2,24,27	7,63,31	58,99,17	12,16,63
1920	25	8,37,62	2,55,46	10,92,48	71,14,04	16,30,70
1921	27	9,38,80	3,00,81	12,39,61	70,89,63	15,65,90
1922	27	8,02,24	2,61,65	10,63,89	61,63,86	12,05,88
1923	26	6,89,05	2,81,39	9,73,14	11,42,82	7,37,01
1924	29	6,90,55	3,80,39	10,70,94	52,50,52	11,29,70
1925	28	6,73,00	3,86,61	10,59,61	51,19,36	10,09,55
1926	28	6,76,34	4,08,05	10,87,39	59,68,02	9,11,04
1927	29	6,88,76	4,19,35	11,08,05	60,81,11	7,69,86
1928	28	6,74,84	4,34,66	11,09,50	62,85,36	8,19,00
1929	33	7,86,97	3,66,54	11,53,51	62,72,03	9,01,99
1930	39	7,44,32	4,40,81	11,85,13	63,21,81	7,66,79

CLASS B —*Banks with Capital and Reserve between Rs 1 lakh and less than Rs 5 lakhs*

(*Figures in Thousands of Rupees*)

Year	No of Reporting Banks	Paid up Capital	Reserve and Rest	Total	Deposits	Cash Balances
1915	25	45,38	9,73	55,11	91,37	20,01
1916	28	51,77	11,56	63,27	1,01,23	16,76
1917	25	44,16	10,24	54,40	99,20	26,42
1918	28	48,65	14,43	63,08	1,55,35	36,06
1919	29	53,11	21,86	74,97	2,28,49	53,71
1920	33	61,42	19,95	81,37	2,33,46	41,91
1921	38	77,05	23,23	1,00,28	2,26,02	43,52
1922	41	83,66	27,65	1,10,63	3,37,89	56,02

[4] This table and the following tables have been taken from *Statistical Statements relating to Banks in India for* 1930

Year	No. of Reporting Banks	Paid up Capital	Rest and Reserve	Total	Deposits	Cash Balances
1923	43	81,11	30,20	1,11,31	4,26,50	61 47
1924	41	7[illegible]	31 31	1 07 60	[illegible]	35 14
1925	40	80 70	37,70	1 18 40	[illegible],41 40	67 80
1926	47	80,[illegible]	[illegible]72	1 25 94	[illegible] 41,87	82,14
1927	48	81 05	47 2[illegible]	1 22 20	4 45 58	[illegible]
1928	40	81 19	[illegible]	1 10,87	[illegible],49 0[illegible]	[illegible]
1929	45	71 94	41 68	1,15 02	[illegible] 57 51	44 05
1930	54	88,09	48,[illegible]	1,[illegible] 77	[illegible] 90 50	51,70

Capital, Reserve and Deposits of the Imperial Bank of India, Exchange Banks, and Indian Joint-Stock Banks in each year from 1921 to 1930

(Figures in Thousands of Rupees)

Year	Imperial Bank of India: Capital and Reserve	Imperial Bank of India: Deposits	Exchange Banks: Capital and Reserve	Exchange Banks: Deposits
1921	9,70,78	72,58,00	1 48,81,27	75,19,61
1922	9 95,57	71,16,30	1,49,62 7[illegible]	73,38,41
1923	10,17,71	82,76,15	1,86,80,40	68 44 28
1924	10,42 78	81,21,18	1,73 05,20	70,63,4[illegible]
1925	10 55,23	83,29,77	1,81,11,17	70 61,57
1926	10,72,00	80,35,06	1,97,33,74	71,54 22
1927	10,86,57	79,27,15	2,11 22 60	68,86,23
1928	11,01,72	79,25,30	2,50,56,40	71,13,86
1929	11,10 26	79,21,28	3 03,50,00	66,95,91
1930	11,15,06	83,06 97	2,58,15,47	68,11,41

(Figures in Thousands of Rupees)

Year	Joint Stock Banks: Capital and Reserve	Joint Stock Banks: Deposits	Total of all Banks: Capital and Reserve	Total of all Banks: Deposits
1921	13,39,80	80 15,65	1,72,00,91	2,27 93,26
1922	11,71 54	65,01,75	1 71 42,86	2,09,56,91
1923	10,81,78	47,69,32	2,07,82,89	1 98,90 05
1924	11,78,93	55,19 58	1,96,16,71	2,10,01,51
1925	11,78,13	57,90,76	2,06,74,84	2,11 75 10
1926	12,10,3[illegible]	63,11 90	2,20,16,06	2,15,04 27
1927	12,30 25	61,29,69	2,61 39,12	2,12,13,37
1928	12,29,37	66,35,02	2,73,87,19	2,16,71,18
1929	12,68,53	66,29,51	3,27,28,79	2,12,19,73
1930	13,51,90	67,52,37	2,82,52,13	2,19,60,76

Proportion per cent of cash to liabilities on deposits of the several classes of Banks on 31st December each year

	1921	1922	1923	1924	1925	1926	1927	1928	1929	1930
I Imperial Bank of India	19	21	18	18	21	26	11	13	18	16
II Exchange Banks—										
(1) Banks doing a considerable portion of their business in India	28	19	19	20	13	14	11	11	15	13
(2) Banks which are merely agencies of large banking corporations doing a major portion of their business abroad	13	33	27	31	15	17	14	11	10	8
III Indian Joint Stock Banks—										
(*a*) Banks having Capital and Reserve of Rs 5 lakhs and over	20	20	17	21	19	15	13	13	14	12
(*b*) Banks having Capital and Reserve between Rs 1 lakh and less than Rs 5 lakhs	13	17	19	13	20	21	15	15	3	12

BRANCH BANKING

There is considerable scope for the development of branch banking in India and the branches of the Imperial Bank of India have been very successful in attracting deposits In England the deposits of the 'big five' amounted to £1,666 millions in 1928 or about 14 times their capital and reserves which amounted to £116 millions, whereas the corresponding figures for the same year of the five biggest banks in India (not the Imperial Bank) were Rs 49 crores and Rs 7 crores respectively

The opening of a branch bank may not always be a remunerative business from the beginning and, therefore, the Indian Banking Committee have recommended that the Reserve Bank when established should place at the disposal of a new branch of a joint stock bank in India at a centre where there is no joint-stock bank, for the first five years, a deposit of such sums on terms and conditions as it may consider necessary Indigenous bankers should be linked up with the Reserve Bank in order that branch banking may develop in India and this will also provide banking facilities in areas where there is no bank in existence It will also strengthen the position of indigenous bankers

At present there is a general tendency for deposits collected at branches by the various banks to be taken to head offices for utilization Thus local places suffer for the sake of the big urban centres even during the busy season when there may be a demand for funds at the mofussil centre It was proposed by certain banking committees that all branches should be compelled by law to invest a certain portion of their deposits in the local place This practice will be undesirable as it will interfere with the freedom of the banks to utilize their resources to the best possible extent and it may be to the disadvantage of the country For this reason the Indian Central Banking Committee rejected their suggestion [5]

Some witnesses urged before the Indian Banking Committee that the competition of the Imperial Bank of India and of the Exchange Banks was too powerful for the Indian joint-stock banks to let them develop along sound lines The Indian Banking Committee do not favour any restrictions on the Imperial Bank to prevent this competition According to them there is no competition with regard to borrowing rates and that with regard to lending rates is commended by them as being beneficial to the public and as a factor in bringing down the incidence of interest charges for local trade In order to ensure a well-ordered development of joint-stock banking in India, the Committee recommend that banks

---

[5] *Indian Central Banking Committee's Report*, p 379

desiring to open new branches should be required to obtain the approval of the Reserve Bank before doing so "Licences should be freely granted to the already established branches and it would be the business of the licensing authority to see that the provisions of the law and any other conditions specified in the licences are complied with"

Banks may not be able to open new branches owing to insufficient business possibilities In such cases they may open sub-offices or part-time branches which can develop in course of time This system proved satisfactory in rural areas in England Then there is the question of economical management In India it is a general complaint that the cost of management of most of the Indian joint-stock banks is disproportionate to their scale of business They have merely been influenced by a false sense of prestige in maintaining more expensive establishments than they can afford to do and they have been content to merely imitate the expensive European models These banks should combine the efficiency of the European model with the economy of indigenous bankers in India The Indian Banking Committee do not say whether this charge is true but they commend the suggestion for consideration to the management of the banks

The Indian Banking Committee do not agree to the suggestion that the Postal Savings Banks should permit deposits being withdrawn by cheques as it would make it more difficult and less attractive for joint-stock banks to open branches at suitable places and it would also interfere with the development of the indigenous and co operative banks The staff of the post office will not be able to cope with the business and a highly paid staff would make the department too costly. The Banking Committee have also recommended that obstacles in the way of mergers among smaller joint-stock banks such as super-tax etc should not be imposed and the existing ones should be removed An exemption from super-tax for a limited period is recommended by them[6] —

Causes Preventing Growth of Indian Joint-Stock Banks

The total number of banks and their branches in India will be seen from the following table[7] —

	Head Offices	Branches
Imperial Bank of India	3	164
Exchange Banks		88
Indian Joint-Stock Banks	171	512
Total	174	764

[6] *Indian Central Banking Committee's Report* p 1 a. 549
[7] *Statistical Tables relating to Banks in India for* 1930

This means that in India there is one bank for every 4,40,000 people There are several urban places and wide areas containing a large number of people where there are no banking facilities The distribution is very uneven In the United Kingdom there is a branch of a bank for every 3,500 people and in England and Wales for every 4,500 The following statement shows the position of bank offices in other countries —

	Bank Offices
U S A	25,000
Great Britain and Ireland	13,100
France	4,400
Germany	3,100
Belgium	1,200[8]

The main causes responsible for the slow development of banking in India are —

(1) *Hoarding habit and direct loans to trade and industry in the form of deposits with firms or companies* —This is not so much a cause preventing the growth of banking in the country as a result of the lack of banking facilities in mofussil places The deposits kept by people with persons having very limited activities of banking show the dearth of banking and the dearth of suitable investments understood by people in which money may be invested, but this is an inevitable phase of transition through which India is passing

(2) *The deterrent effect of bank failures in India* —People naturally show great apprehension regarding the safety of their funds because credit is a very delicate thing The figures of failures from the year 1921 to 1930 are given below[9] —

Year	Number of Companies	Authorized Capital	Subscribed Capital	Paid-up Capital
		Rs	Rs	Rs
1921	7	70,40,000	5,80,965	1,25,329
1922	15	10,15,55,000	27,25,744	3,29,991
1923	20	21,86,89,995	9,92,36,480	4,65,47,325
1924	18	6,30,30,925	26,46,370	11,23,623
1925	17	1,89,80,000	25,41,695	18,75,795
1926	14	70,80,000	7,05,815	3,98,145
1927	16	69,30,000	6,83,372	3,10,518
1928	13	81,70,000	31,65,740	23,11 717
1929	11	1,50,50,000	24,99,050	8,18,972
1930	12	6,27,40,000	46,55,445	40,59,644

[8] *Minority Report of the Indian Banking Committee*, p 115
[9] *Statistical Tables relating to Banks in India for* 1930, p 35

The Indian Banking Committee did not investigate this question and in this connection Mr Manu Subedar in his *Minority Report* writes "I regret that the committee did not investigate the question of the total bank failures in this country since the establishment of Government by the Crown, and the amount of money that was lost in these failures It might have pointed out whether the bank failures have been greater and more disastrous in India of banks under European management, or of banks under Indian management It might have also brought out whether they have been in excess of similar failures in other countries in the early period of the growth of banking on modern lines On both these questions my personal feeling is that the failures under Indian management have by no means been greater or more disastrous and I also feel that India has not passed through an excessive death rate in banks compared to other countries "[10]

Unfamiliarity of people with joint-stock enterprise is responsible for this bank mortality to a great extent A bank failure is of necessity much advertised This publicity may help a bank like the Imperial Bank to which the depositors may turn, but it immediately penalises an Indian concern in which deposits are not renewed

(3) *The attitude of Government and public authorities* —"Without any desire to drag in political considerations of any kind, it may be mentioned that the Indian efforts in the field of banking have seldom been viewed with enthusiasm and have been generally regarded with suspicion in official circles it is not that the discretion vested in officials was abused, but that it was used with undue severity, which led to a generalization on the part of the public and of the banks, which were aggrieved, that the official opinion was generally hostile "[11]

In this connection it may not be out of place to mention that in 1932 the Government of Bombay issued a circular wherein it was shown that it was dangerous to insure goods with Indian insurance companies [12] It is from such things that the Indian public probably conclude—naturally though—that the official attitude is not favourable to Indian banks

(4) *Competition and opposition of foreign institutions* —The most advantageous points have been held by the foreign banks and the most profitable business is in their hands ' They do not care for the less profitable (business) which they leave to Indian institutions, but they are watchful of every Indian institution that gathers strength and that can

---

[10] *Minority Report* of Mr Manu Subedar, pp 116 and 117
[11] *Ibid* p 119
[12] See the *Report of the Federation of Indian Chambers of Commerce and Industry*, 1932, pp B17 and B18

prove to be a possible rival Their policy is thus the general policy of monopolists, *viz*, give minimum service to get maximum return" (*Minority Report of the Indian Banking Committee*, p 120)

(5) *Limited trade and business in Indian hands*—Banks prosper when trade and industry thrive but when the profits of the latter fall, banks also suffer and a very large portion of our trade being in the hands of foreigners, this is naturally a disadvantage to Indian banks, because foreigners naturally prefer their own kith and kin to Indians

(6) *Preference to Indian Banks*—National sentiment affects business all over the world Foreign banks encourage foreign insurance companies and shipping companies, etc, and the latter in their turn encourage the former This tendency is not noticeable among Indian firms of brokers and agents who are subordinate to foreign houses "The absence of such sentiment is undoubtedly a handicap to Indian institutions, and if it is desired that this handicap should be removed, measures would have to be taken from the top to make this possible"

(7) (*a*) Entry into clearing houses of Indian joint-stock banks is difficult The decision to take in a new member depends upon the majority which consists of foreign institutions and they raise difficulties

(*b*) New Indian banks and those specially small cannot expect to be preferred to the older institutions

(*c*) "There is reason to believe, that Indian institutions generally and new Indian joint-stock banks in particular, are disparaged by the superior staff of foreign institutions There are a large number of brokers, middlemen and others, including actual and prospective borrowers and bank clients, who constitute the medium through which ridicule, disparagement and discouragement against Indian banks in general, and new Indian institutions in particular, are transmitted to the Indian public"

(8) *Dearth of Capital*—There is a definite limit to banking expansion in India which is set by the available funds A large number of people have made investments in trade and government securities and if the atmosphere of the banks for the success would be favourable, there is no reason why banks should suffer from a dearth of deposits or share capital There are numerous banking institutions in India which are not working to their full capacity and many smaller banks could offer a nucleus by amalgamation

(9) *The absence of cheque habit and transactions being to a great extent on a cash basis*—There is lack of familiarity

not only with the use of cheque but of credit instruments in general, and this fact restricts the operations of established banks and the scope for new banks If banks could use vernaculars for cheques along with English, this might go a long way to familiarize people with the use of cheque Hundi being an indigenous credit instrument has been in vogue in India since long and the cheque habit can develop if cheque forms are printed in local vernaculars

(10) *Legal hindrances*—The development of the credit system depends upon the efficiency of a legal system designed to protect and safeguard the rights of individuals and to enforce a prompt fulfilment of transactions Credit will become dear if the lender has to take risks of unfair treatment in law courts and cannot be sure of liquidating his loans by selling off the mortgaged property The property forms a good security only if it is transferable without legal or customary hindrances. If there are such restrictions on free transfer of the property, the banker will find it difficult to advance loans to customers. The Land Alienation Acts and certain Hindu and Mohammedan Laws and customs relating to succession and transfer of rights present great difficulties in the way of bankers in India in giving financial accommodation on bankable security These difficulties should be removed if credit is to be made cheap in India

Remittance Facilities

Commercial banks render a very useful service inasmuch as they transfer money quickly and economically from one place to another The Imperial Bank charges one anna per cent on sums over Rs 10,000 and allows a concession of 50 per cent to joint stock banks over sums above Rs 10,000. The charges made by joint stock banks to their customers vary with the demand and supply of funds and the cost of internal remittance in India is said to be higher than in other countries In this connection the Indian Banking Committee write "We recommend that it should be reduced as far as possible with a view to a better utilization of the resources of the country and a lowering of the rates of interest generally throughout the country If transfers of money for member banks and bankers were made by the Reserve Bank free of cost as a national service, it would, we think, have a good influence on the equalization of interest rates throughout the country "[13] The views of the Royal Commission on Indian Currency and Finance may also be usefully quoted in this connection which are —

[13] *Central Banking Committee's Report*, para 566

"In any scheme of banking reform that may be planned, we trust that due emphasis will be laid on the provision and extension of cheap facilities to the public, including banks and bankers, for internal remittances"[14]

The Imperial Bank should reduce the remittance cost to the public by charging half anna per cent for remittance of Rs 10,000 and above to transfers between any two banks In rural areas the facilities can be extended by co-operative societies

The Question of Liquidity

Great stress has been laid on the maintenance of proper liquidity on the part of Indian banks It is, of course, necessary that a bank must honour the cheques of its customers on demand The banker must have sufficient cash resources or other working arrangements by which he must be able to meet his obligations, otherwise people will lose confidence and banking habit would be discouraged Of course, the question of percentage to demand liabilities is a matter of public opinion In agricultural communities and in countries where banking habit is little developed and familiarity with the use of credit instruments is comparatively less, a higher percentage may be desirable In Western countries the dishonouring of a cheque because of lack of cash resources has become an uncommon thing

Various methods have been suggested to achieve this object and one of them is the system of a Bankers' Bank which may be a sort of a 'case of need' for the banker to help him in honouring the cheques of his customers The other method is that commercial banks should confine themselves to short-term advances The foreign banking experts have suggested that all long-term loans must come from special institutions and that industrial requirements except for small seasonal needs must be met from debentures But it has to be remembered that debentures are not as familiar in India as in Western countries partly because of lack of sufficiency of savings and partly because of unfamiliarity of people with this form of investment Mr Manu Subedar remarks in the *Minority Report* "In Western countries the loans of commercial banks are for short period in form but without rigidity Consciously and deliberately, banks play a very important part in the financing of industry and they engage the funds not by mechanical rules of period, but according to the needs of their clients so long as they feel safe about the ultimate return of their money What happens in practice is that the deposits, which

---

[14] *Report of the Royal Commission on Indian Currency and Finance*, 1926, para 215

are short-lived, are also renewed, similarly, loans, which are on the face of them, short period get renewed Many authorities could be quoted to show that, with regard to banking systems in many countries, an undue emphasis in practice on short term loans would defeat its own object, and considerably detract from the service, which banks can render to trade It is necessary to lay down some standards, but not impossible standards, and the interdiction to banks, consciously to make loans, which would be recovered not in six or twelve months but in two and three years even under absolutely safe conditions as to security, is not justified This does not again mean that there should be no relation in volume between such loans and the total working capital of the bank or that there would not be need to scrutinise much more carefully loans extending over some time, since the change of economic conditions weakening the borrower, or the enterprise, is more likely in the long period than in the short one The rule, which makes self-liquidating trade bills the best investment for a bank, has reference more to liquidity than to soundness and it would be a confusion of ideas if other considerations are all set aside and an attempt made to put before the Indian banking world models which do not exist in reality '

' Banks have to provide for two things, *viz*, their ultimate solvency by taking care that the loans advanced by them will be recovered This is elementary This judgment is wanted of banks They have to provide for this by judging the credit of clientele and their resources carefully when they give clean advances, and, if they are not sure, by taking adequate securities No one from outside can help them, if they fail to do this, but the second requirement *viz*, their ability to meet any abnormal, sudden or emergent demand is one, in which they are entitled to help from the Reserve Bank Securities, which they possess, if they are adequate and sound as banking securities go, should be converted promptly into cash to help the institution to meet a crisis '

POSSIBILITIES OF EXPANSION

There are great possibilities of expansion along various lines for Indian joint-stock banks They should have some security against undue competition at the hands of foreign banks With the concession attached to joint stock banks some private bankers might take themselves to joint-stock banking business or they might group themselves up in a separate bank Amalgamation of smaller institutions, particularly in South India, might be helpful provided the state

---

[15] *Minority Report* of Mr Manu Subedar to the *Indian Banking Committee's Report*, pp 128-132

could take a hand in the matter The loan offices in Bengal and Nidhis offer another promising raw material for the emergence of joint stock banks Central co-operative banks might, within limits, take to general banking business which will make them popular with and known to the general public

Joint-stock banks should build up strong reserve funds and cheque system should be encouraged as indicated above The Indian joint stock banks need protection against foreign banks and the field of internal banking should be reserved for the former

Table showing percentage ratio of Banks' own resources to their Public Liabilities excluding acceptances and sundry accounts, at the end of each year indicated

Country	1913	1920	1921	1922	1923	1924	1925	1926	1927	1928	1929
EUROPE											
Austria[1]	33 3	7 5	3 8	4 4	17 8	19 8	17 4	14 2	14 5	13 9	15 1
Belgium	24 3	15 1	16 1	17 1	16 8	19 5	16 8	15 4	15 7	21 5	25 6
Czechoslovakia[2]		11 6	10 4	10 7	11 7	12 7	12 7	13 4	11 5	11 6	12 2
Denmark[3]	30 8	14 7	15 7	15 4	15 7	16 5	14 2	15 0	15 5	17 8	17 5
Finland	22 0	24 9	22 6	20 1	18 3	16 9	17 7	16 8	19 1	19 0	19 4
France[4] (a)	19 8	8 9	9 3	9 0	8 3	8 7	6 6	6 1	5 4	4 5	8 3
France[4] (b)	55 3	32 0	38 9	36 6	29 6	26 1	17 5	19 5	14 6	13 3	19 2
France[4] (c)	24 7	11 5	12 5	11 5	10 5	10 7	8 0	7 6	6 6	5 4	9 5
Germany[5] (a)	30 2				56 3	22 2	17 0	14 8	12 8	11 6	9 3
Germany[5] (b)	30 3	4 0	4 1	0 8	59 8[6]	19 6	14 0	11 8	9 9	8 0	7 5
Greece[7]	50 8	12 5	11 7	12 8	8 8	9 9	13 9	12 6	11 5	20 3	20 4
Hungary[8]	18 9						31 5	23 8	20 1	16 5	16 8
Italy[9]	31 1	7 8	7 6		10 5	10 0	12 8	13 7	13 1	13 3	13 6
Netherlands[10]	52 8	29 4	30 7	34 5	33 4	32 1	30 8	29 8	27 2	27 5	28 0
Norway[11] (a)	18 3	24 2	21 8	21 2	15 6	13 5	11 4	10 7	9 9	11 2	12 2
Norway[11] (b)							19 2	19 0	18 4	18 8	18 7
Poland[12]		11 1	8 4	5 2		14 9	22 4	17 4	14 0	14 7	14 2
Roumania		30 0	21 0	20 7	24 9	24 9	29 6	22 4	22 9	22 6	23 3
Sweden	32 0	18 7	19 8	20 1	18 9	19 7	19 5	19 5	19 4	19 9	19 7
Switzerland	21 7	16 7	17 5	18 2	18 0	17 2	16 5	16 1	16 2	16 2	15 7
U K AND IRISH FREE STATE											
England and Wales	10 1	6 5	6 5	7 0	7 1	7 3	7 5	7 5	7 4	7 3	7 4
Scotland	12 7	5 7	5 8	6 7	7 5	8 4	9 0	9 4	9 5	9 5	10 1
Ireland	14 1	5 7	5 6	6 1	6 9	7 9	8 5	8 9	9 3	9 0	9 8
Yugoslavia	'	'	19 2	29,0	27,6	25,8	22 2	21 8	21 4	21 5	21 3

Observations

[1] Principal commercial banks

[2] Joint stock banks in Bohemia, Moravia and Silesia

[3] 1913 and 1920 principal commercial banks, since 1921 all commercial banks

[4] Principal commercial banks (a) Deposit banks, (b) Investment banks, (c) Total

[5] (a) Up to 1928 inclusive all joint stock commercial banks (corresponding data for 1920 22 not available), in 1929 all monthly reporting commercial banks The corresponding ratio for the latter group of banks at the end of 1928 and 1930 was 10 4 per cent and 9 7 per cent respectively, (b) Principal commercial banks

[6] According to gold balance sheets for January 1st, 1924

[7] Up to 1929 inclusive principal domestic banks, 1928 and 1929 all banks including the National Bank of Greece, now a commercial bank Pre war figures refer to 1914

[8] The ratio of the banks' own resources to public liabilities excluding mortgage bond issues and

NORTH AMERICA											
Canada	17.5	9.6	10.5	11.0	10.4	9.5	9.4	9.3	8.9	8.4	9.8
U S A[13] (a)	19.8	12.0	14.0	14.2	13.7	14.2	12.7	13.0	13.0	13.5	15.6
U S A[13] (b)	18.0	11.0	13.3	13.4	13.1	12.5	12.1	12.4	12.3	12.9	14.2
LATIN AMERICA											
Argentine[14]	39.0		18.5	17.3	17.0	15.4	15.3	15.2	14.7	13.3	
Brazil[15]	38.0	20.9	19.5	16.3	17.5	19.9	22.5	21.1	20.5	18.9	
Chile	42.3	32.7	37.4	44.9	44.7	47.2	46.9	38.1	48.6	42.7	12.0
Colombia					30.0	47.9	32.6	32.4	40.0	33.4	15.6
Mexico							60.5	69.8	68.2	39.2	18.5
Peru	21.9	11.9	12.5	18.9	20.4	18.9	19.3	20.7	24.5	26.8	
SOUTH AFRICA AND OCEANIA											
Union of South Africa[16]	16.2	8.4	9.5	10.7	9.7	10.0	9.9	11.9	11.9	11.4	12.2
Australasia[17]	22.2	13.5	14.3	15.9	16.0	17.1	18.6	19.3	19.5	20.2	20.2

sundry accounts was 33.2 per cent in 1913, 18.8 per cent in 1929 and 17.8 per cent in 1930.

[9] Principal commercial banks.

[10] Principal commercial banks.

[11] (a) All commercial banks. (b) excluding banks under public administration or liquidation.

[12] Data for 1920 not available.

[13] (a) All commercial banks, (b) National banks. Figures refer to the end of June each year; pre-war figures to June 1914.

[14] All important commercial banks, including the Banco de la Nacion.

[15] Including the Banco do Brasil with the exclusion of its note issue department.

[16] Including the accounts of the branches outside the Union.

[17] End of June each year. Complete accounts of all important banks in Australia and New Zealand, including offices in London and branches elsewhere outside these countries.

* See *Commercial Banks*, 1913–1929, p. 20, League of Nations 1931 Edition

CHAPTER IV

Imperial Bank of India

THE Imperial Bank of India was formed in January 1921 by amalgamating the Presidency Banks of Bengal, Bombay and Madras and is governed by a special Act known as the Imperial Bank of India Act No XLVII of 1920 This consummation was brought about because of the experience of war time which clearly brought to light the weak points of the Indian Banking System and taught the advantages of union

The total authorized capital of the Imperial Bank consists of 225,000 shares of Rs 500 each and the paid up capital consists of 75,000 shares of Rs 500 each of which Rs 125 per share is paid up There is a Central Board consisting of two managers, the Controller of Currency as the *ex officio* member of the Board, the President and Vice-President of each local board the Secretary and Treasurer of each local board having no voting power and four non-official members to be appointed by the Governor-General in Council to represent the interests of the tax-payers The business of this Board is to settle disputes between local boards, to publish the Bank s weekly statement, to deal with matters of general policy, to fix the Bank Rate from time to time and to look after the discount policy The Board is to meet alternately at Bombay and Calcutta once at least every quarter of a year and the Managing Board has to meet oftener to transact business

It is a commercial bank with private shareholders and competes with other banks to a certain extent Its predecessors were performing certain functions of a Bankers Bank and on account of this reason and because it has additional responsibilities as the banker of the Government, the Imperial Bank is subjected to the following restrictions —

(1) The Bank cannot make loans or advances for more than six months

(2) The Bank is prohibited from granting loans upon the security of its own stocks and shares

(3) Immovable security cannot be accepted as the original or principal security for the loans though it can be accepted as subsidiary or secondary security

(4) The Bank cannot lend more than Rs 20 lakhs to or discount bills of a higher amount of any individual or partnership firm except on the security of trustee

(2) It manages the public debt of India and also raises loans on behalf of the Government. Its London office manages the rupee debt in London for a fixed remuneration.

OTHER BANKING FUNCTIONS

(1) It acts as a Bankers' Bank and most of the leading Indian banks keep their cash balances except the till money with the Imperial Bank. On the 30th September 1930 the cash balances of the Exchange and Indian joint-stock banks were Rs. 188 lakhs and Rs. 105 lakhs respectively.[1]

(2) The Bank also manages the Clearing Houses which are eleven in number, the supervising staff being supplied by the Bank.

(3) The Bank was to open 100 new branches within the first five years of its inauguration and by the end of December 31, 1930, 164 new branches were opened.[2] Where the Bank has no branches, it utilizes the services of the Indian joint-stock banks, leading local merchants or Sneroffs for collecting cheques or other bills of exchange.

(4) The Bank gives elasticity to the currency system of India in the busy season. It can get loans from the Paper Currency Department to the extent of Rs. 12 crores in the busy season on the security of Hundis or internal bills of exchange provided the minimum Bank rate is at least six per cent.

(5) It provides remittance facilities to the banks and the public in India. The charges from a member of the public are $\frac{1}{4}$ per cent on sums up to Rs. 1,000, $\frac{1}{8}$ per cent on sums between Rs. 1,000 and 10,000 and $^1/_{16}$ per cent on sums above Rs. 10,000. The charges for banks differ. The usual rate has to be paid by a bank to purchase remittance to a place where the purchasing bank has no branch. The rate for sums above Rs. 10,000 is reduced to $^1/_{32}$ per cent when the purchasing bank purchases a transfer from one of its branches to another.

BANK RATE

The Bank Rate indicates the rate at which the Imperial Bank is prepared to lend money on government securities.

Average Bank Rates of the Imperial Bank of India from 1921 up to 1930[3]:—

[1] *Indian Banking Committee's Report*, p. 21.

[2] *Statistical Tables relating to Banks in India*, 1932, p. 3.

[3] *Ibid.*, p. 9.

Year	Half Year ending 30th June	Half Year ending 31st December	Annual Average
1921	6 04	5 11	5 57
1922	7 13	4 51	5 81
1923	7 42	4 50	5 96
1924	8 05	5 32	6 68
1925	6 58	4 70	5 64
1926	5 65	4 70	5 17
1927	6 51	4 96	5 73
1928	6 94	5 46	5 20
1929	6 88	5 79	6 33
1930	6 51	5 28	5 89

A recent writer[4] in this connection remarks "The most noticeable feature of the Bank Rate is that the Imperial Bank does not effectively control the money market just as the Bank of England controls the money market in London Again, the expected lowering, levelling up and equalizing of the extremely high rates that prevail for banking accommodation in our country during the busy season has not been realized The ideally low Bank Rate of France or Germany or England has not been reached Of course, this is due to the government borrowings either in the way of the short-dated Treasury Bills or permanent loans for longer periods Unless it gives up long-term borrowing there would not be the possibility of collecting surplus cash in the hands of the Imperial Bank and a lowering of the Bank Rate The seasonal swings for currency are no doubt responsible for seasonal fluctuations in the Bank Rate, but still the prevailing high rate of discount is chiefly due to the insufficiency of capital in the country "

Expected Advantages of the Bank

(A) *For the general public*

(1) The public would gain much by the popularization of the banking business, and the opening of branches by the Bank backed up by Government would create confidence into the public regarding their willingness to entrust their money with the Bank

(2) A training would be provided in banking business to Indians which would train up recruits for banking business and provide employment to them Being a semi-public institution, the Bank was expected to train up Indians in the banking business

(B) *The Bank's customers*

(1) High discount rates were expected to be reduced as a result of a fuller utilization and a more elastic use of

---

[4] Rau *Present-Day Banking in India*, p 42

government balances and a steady, uniform and cheapened rate was to advance the industrial development of the country

(2) A proper and wide distribution of capital was another likely advantage The London Branch was to keep the Bank in touch with the most important financial and monetary centre of the world, and it would obtain trustworthy information in connection with English concerns interested in Indian trade

(3) The increase in branches and the ability to discount more credit instruments implies that the Imperial Bank would render a great service to the trade and commerce of the country

(C) *The Government*

(1) The Government stands to gain because a lot of money locked up in the reserve treasuries during the busy season which causes stringency in the money market, can be and is utilized as the reserve treasuries have been abolished This money will be transformed 'from mere warehouse merchandise into an active banking power' The Government has discontinued issuing currency transfers to the public between any two places in which there is a head office or a branch of the Bank This means that the Bank will be responsible for transferring funds and making them available to the public and the Government

(2) The decentralization of the public debt will improve its administration and enable small investors to make investments and to go in for Government securities oftener than now

(3) "If the management of the balances of the Secretary of State and his banking and remittance business were to be performed by the Imperial Bank's branch office in London it would save him a lot of carping criticism by the unenlightened public"

(4) Loans could be floated at a low rate of interest by the Government

(D) *The Imperial Bank*

The Bank has an advantage inasmuch as it occupies a privileged position of a Bankers' Bank It can successfully play this part as it has the backing of the Government Its successful work will inspire confidence in the public and thus make it a bulwark of public confidence It should not, however, be a merely profit-making concern, but should have its eye on the interests of the country

The joint-stock banks the co-operative banks and the exchange banks also stand to gain inasmuch as they will get guidance, help and support from the Bank and it will come to the rescue of the Indian banks in case of need

ADVANTAGES REALIZED

All the expected advantages mentioned above have not materialized, but certain achievements stand to the credit of the Bank. Firstly, the great differences formerly prevailing between the Hundi Rate and the Bazaar Rates have been considerably reduced. Secondly, the great irregularities between the Madras, Calcutta and Bombay money rates have been equalized to a great extent. The following table shows the differences between different rates prior to the establishment of the Imperial Bank:—

Average Bank Rate of the Presidency Banks

Year	Bank of Bengal	Bank of Bombay Annual Average[5]	Bank of Madras
1870	5.73	5.25	4.50
1875	5.66	7.23	7.00
1880	4.65	5.01	5.37
1885	5.38	4.95	4.47
1890	5.79	6.24	5.73
1895	4.33	3.95	4.26
1900	5.34	5.35	5.87
1905	5.09	5.09	5.11
1910	5.33	5.16	5.91
1915	5.69	5.57	5.70
1920	6.06	6.37	6.20

Further, elasticity has been introduced into the credit system by the issue of emergency currency according to the Paper Currency Act of 1923. The Bank has also opened a number of branches in the various parts of the country and thus given encouragement to the development of deposit banking and cheque system. It has helped a number of banks in times of crises and its help to the Alliance Bank of Simla may be cited on the point. Merchants and traders are making increased use of the internal remittance facilities provided by the Bank. This has been due to reduction in remittance charges. The Imperial Bank has cultivated relations with the Apex Provincial Co-operative Banks by allowing them the advantage of overdraft system. It has also enabled the middle-class investors to subscribe to the loans issued by the Government and has thus been responsible for promoting the accumulation of capital in the country.

ITS SHORTCOMINGS

It has not fulfilled the expectations of the Indian public in regard to its attitude towards India's economic interests. The Bank was expected to rise to the full dignity and stature

---

[5] *Statistical Tables relating to Banks in India*, 17th issue, 1932, p. 9.

of a central bank It was thought that it would act as the depository of the cash reserve of other banks and do more business with them than with the public and that it would care less for profits than for industries and trade and would develop the acceptance business On these points the Bank has been very severely criticized[6] Mr T Goswami in his *Minute* appended to the External Capital Committee's Report writes, "I should like to express the common belief—for which I know there is a good foundation in actual facts—that racial and political discrimination is made in the *matter of credit and* that Indians usually do not receive in matters of credit the treatment that their assets entitle them to, while, on the other hand, British businessmen have frequently been allowed longer credit than what on ordinary business principles they ought to have got This is a matter for enquiry"[7] We come across the following statement in the *Minority Report* of the Indian Banking Committee already referred to above "In his evidence before the Central Banking Enquiry Committee, the Managing Governor took pains to point out the number of industries, to which assistance has been given, and to refute the suggestion that industries in India did not receive assistance at the hands of the Imperial Bank Specific complaints came to us in connection with the loans given out by the Imperial Bank to tea gardens, such loans being confined to four English brokers, through whom alone the Imperial Bank acted The fact that the superior staff of the Imperial Bank is wholly English, may be at the root of this feeling widely held, and this feeling holds an important place in Indian public opinion. The fact of the existence of Indians in the Central and Provincial Boards does not appear to have made serious impression on the adverse feeling in Indian circles"[8]

The fact that the Imperial Bank competes with the Indian joint-stock banks has been a source of bitter complaint for the latter In his oral evidence before the Hilton-Young Commission, Volume IV, page 93, Mr Bowie said, "Placed above economic competition by virtue of its character as a quasi-state bank, it has begun to compete with the indigenous joint-stock banks that have been left powerless to withstand

---

[6] Mr Manu Subedar, in his *Minority Report to the Indian Banking Committee*, writes, "On many occasions either after or before amalgamation, it could have helped other institutions at a slight cost or inconvenience to itself But it has acted in many directions in a truly imperial fashion Not only in its relation to joint stock banks and co operative banks, were complaints placed before us, but in other directions also in the past, discrimination against Indian interests by the Imperial Bank has been suspected" *Minority Report*, p 263

[7] *External Capital Committee's Report*, p 24

[8] *Minority Report of the Indian Banking Committee*, p 264

this competition. The exchange banks are, however, free from this economic competition on the part of the Imperial Bank.* In this connection the views of the Indian Banking Committee are somewhat [illegible]. The position of the Imperial Bank of India in relation to Government gives it an advantage over the Indian joint stock banks, but its competition [illegible], though according to [illegible] There is no competition [illegible] to borrowers [illegible] in regard to lending [illegible] to the public. It has brought down the [illegible] of rates and charges for [illegible] trade."

Another complaint [illegible] is that it has not done enough to train Indians for responsible posts in the Bank. The following table taken from the Indian Banking Committee's Report shows the position in this respect:—

Year	Recruited from London		Recruited from the staff in India
	Europeans	Indians	Indians
1925	2	1	12
1926	6	1	
1927	1	1	1
1928	4	1	[illegible]
1929	6		7
1930			1

The following figures were submitted by the Managing Governor of the Imperial Bank of India to the Central Banking Committee regarding the recruitment of European and Indian officers from 1925 to 1930:

Bengal Circle		Bombay Circle		Madras Circle	
Europeans	Indians	Europeans	Indians	Europeans	Indians
27	13	18	1	11	9

(*Central Banking Committee's Report*, Vol II, p 159.)

In this connection Mr N. R. Sarkar observes in his *Minute of Dissent* to the Report of the Indian Banking Committee as below:—

"I am not satisfied with the Indianization policy of the Bank. According to the figures furnished to us, ten years of working of the scheme have not produced the desirable result. There are now only 33 Indian staff officers against 80 Europeans and I understand that the number of Indians is not more now than it was in 1925. During the year 1925 the Bank appointed 32 Europeans to the higher grade and only 11 Indians. Since then 23 Europeans have been appointed as

* *Report of the Indian Banking Committee*, p 570

against 17 Indians" (*Central Banking Committee's Report*, p 525)

The Indian Banking Committee in paragraph 483 of their Report have recommended that if the Imperial Bank is given the concession of being appointed the sole agent of the Reserve Bank at certain places in India in connection with its entry into the field of foreign trade finance, no further recruitment of non-Indians to the superior staff of the Bank should be made except in special cases with the approval of the Finance Minister of the Government of India, but they have not suggested any change for the interim period They write, "If the privilege of the free use of the Government balances and other concessions now enjoyed by the Imperial Bank of India is a consideration in favour of the proposal of further Indianization as urged by witnesses, it has also to be remembered that these privileges are not given without a *quid pro quo* and that the Imperial Bank of India has to incur a large expenditure on account of the staff employed for carrying on the Government Treasury business We should at the same time like to add that the question of Indianization stands on its own merits as a matter of policy in India"[10]

The Government of India keeps with the Imperial Bank higher cash balances than it used to have with the Presidency Banks as is shown by the following table —

(*In Crores of Rupees*)

Year	Maximum Government Balances	Minimum Government Balances
1913–14	6 18 October	4 85 May
1914–15	10 12 August	4 84 November
1915–16	8 87 August	4 42 November
1916–17	10 4 March	4 84 May
1917–18	22 65 June	7 37 November
1918–19	18 60 September	6 54 April
1919–20	18 26 February	7 04 September
1920–21	20 38 July	5 84 February
1921–22	25 87 July	5 34 November
1922–23	33 15 July	8 22 November
1923–24	29 74 July	6 22 November
1924–25	32 18 July	7 42 December
1925–26	28 96 May	4 29 December
1926–27	36 41 July	3 85 December
1927–28	19 97 April	3 05 December
1928–29	17 20 August	3 71 April
1929–30	20 65 June	5 88 June

[10] *Indian Banking Committee's Report*, pp 372, 373

The advantage of such interest-free balances is that the Bank makes profits for its shareholders. The following monthly figures for seven years show that the Imperial Bank keeps very large sums of money belonging to the Government even in the busy season —

Government balances with the Imperial Bank of India
(In Lakhs of Rupees.)

Slump Season —

Month	1923-24	1924-25	1925-26	1926-27	1927-28	1928-29	1929-30
April	11,83	19,82	27,09	13,06	11,51	7,14	10,09
May	12,38	20,36	28,13	11,83	11,86	6,63	8,59
June	12,51	22,01	22,26	32,30	9,81	7,90	10,65
July	29,49	32,18	21,54	36,29	15,58	6,20	13,07
August	23,12	32,06	19,62	35,45	15,74	16,92	12,44
Sept	15,76	25,27	9,96	20,23	12,56	5,76	20,01

Busy Trade Season —

Month	1923-24	1924-25	1925-26	1926-27	1927-28	1928-29	1929-30
Oct	7,79	11,30	7,10	11,03	8,76	6,32	15,19
Nov.	8,12	10,31	6,71	9,16	9,66	7,69	14,00
Dec	8,56	7,13	5,26	6,33	7,04	7,73	7,05
Jan	16,92	17,91	9,90	13,11	7,88	8,06	17,36
Feb	22,63	21,01	13,86	20,16	7,32	10,29	18,26
March	26,91	27,15	21,16	21,62	6,03	5,60	12,39

The Imperial Bank of India is curtailing facilities to co-operative banks. This is clear by a perusal of the evidence of various witnesses who appeared before the Central Banking Committee. (For details, consult the *Report of the Central Banking Committee*, Vol II, pp 77, 78, 87, 103 and 126.)

In the *Indian Central Banking Enquiry Committee's Report*, we come across the following passage —

"The policy of the Imperial Bank of India in regard to the grant of financial assistance to some of the provincial and central co-operative banks seems of late to have undergone a definite change, and it is stated that it shows to-day a much smaller measure of readiness to help them than it used to do in the past. The ultimate result, therefore, of the action of the Imperial Bank will probably be to make money dearer to the agriculturists. It is also pointed out that the entire limit of credit hitherto allowed to all the co-operative banks in India on the cover of societies' pronotes is no more than Rs 73 lakhs, part of which was used for short-term loans and the rest was mostly left undrawn to serve as fluid resources. This was a comparatively small sum for the Imperial Bank for its large resources. Moreover, as the Bank enjoys the benefit of the large free balances of Government there is a moral obligation on the part of the Bank to finance the agricultural co-operative societies and if any change in the existing

arrangements is at all called for it is in the direction of turning that moral obligation into a contractual guarantee or a statutory liability We feel that the change of policy to which we have referred is unfortunate, especially at a time when the co operative movement is growing in vitality and is extending the scope of its usefulness towards the social and economic uplift of the rural population and when its financial needs are, therefore, likely to increase rapidly " (*Report of the Central Banking Committee*, Vol I, p 143, 144)

The Bank has also failed to develop the banking capital in the country Up to 31st March 1926, the Bank opened 102 new branches, 50 of which were opened at places where there were branches of Indian joint stock banks Some of the branches of the Bank have not yet reached a profit-making stage It has failed to attract more private deposits now than in 1920, though, of course, it must have deviated the deposits from other joint-stock banks

Deposits of various classes of banks for years 1919–30

(In Crores of Rupees)

Year	Imperial Bank of India Private Deposits	Exchange Banks	Joint-Stock Banks	Total
1919	68	74	61	203
1920	78	75	73	226
1921	66	75	80	221
1922	74	68	48	190
1923	74	68	48	190
1924	77	71	55	203
1925	78	71	58	207
1926	74	72	63	209
1927	72	69	64	205
1928	71	71	66	208
1929	72	65	66	203
1930	77	68	67	212

The foreign experts maintained that the failure of the Bank to create new banking capital was due to the fact that the country was not "bounding with untapped banking possibilities" This statement cannot be accepted as correct and the Indian Céntral Banking Enquiry Committee in paragraph 538 of their *Report* write, "It is not however correct to infer that the banking resources of India are limited "

The main reasons as given by a Madras witness in his evidence before the Central Banking Committee are the following —

(1) The reserve and aloofness of the officials of the Bank and branch agents who are generally Europeans

and do not know the local languages and cannot freely move with people,

(2) The inordinate delay caused in every transaction,

(3) The indifference towards the customers,

(4) The distance of the office from the business locality, and

(5) The unwillingness to have correspondence in vernacular at least to some extent

The Bank has not been able to fulfil the high expectations made of it regarding the provision of finance to industries and agriculture The commercial community in modern times expects its banking organization to provide finance for all kinds of its needs The Agricultural Mortgage Corporation in England for the supply of agricultural credit is the result of the efforts of British joint-stock bankers and the British Securities Trust set up to rationalize the cotton textile industry has been started under the auspices of the Bank of England and these institutions point out the way in which the Indian Banking system needs reform The *Bihar and Orissa Banking Committee Report* states, "It will be seen that the Imperial Bank and the joint-stock banks play no important part in financing the industries of the province" An important witness from Bombay before the Indian Banking Committee said, "It has been alleged that the Imperial Bank practically tried to discourage and paralyse the textile industry by demanding money when there was a crisis and strike in Bombay last year If His Exalted Highness the Nizam of Hyderabad had not invested a crore of rupees in the Bombay textile trade, that industry would have been doomed The Bank financed the English racers at Calcutta with a very large capital, while they could not accommodate the textile mill industry in Bombay and on the contrary they demanded money from the agents of the mills at a very inopportune and critical time' (*Indian Central Banking Committee Report*, Vol II, p 377)

The Bank has thus failed to develop a Central rediscounting agency and an open discount market does not exist where the bills can be discounted It has not adopted the practice of appointing local people to help the branch managers in the matter of discounting bills It has not provided adequate finance to industry and agriculture and is curtailing facilities to the co-operative movement Banking capital in the country has not been developed and to a certain extent Indian joint stock banks have been injured as a result of the establishment of its branches in places where those of the latter already exist Allegations of discrimination as against different classes of customers, industries and places are also prevalent and

to a very great extent the Bank has depended upon Government balances which are supplied to it free of interest

THE RELATION OF THE IMPERIAL BANK WITH FOREIGN BANKS

The Presidency Banks and Exchange Banks had occasions for mutual jealousy and suspicion The foreign banks were intolerant of the Presidency Banks because of the privileges of the latter The sphere of the Presidency Banks was internal trade and that of the foreign banks was foreign trade and the latter tried their best to keep the former out of their foreign trade business The Presidency Banks in spite of the backing of the Government could not get their restriction removed The Presidency Banks on the other hand complained that the Exchange Banks did enter into internal trade business and this complaint was definitely admitted before several commissions of enquiry [11]

The Imperial Bank secured a profitable partnership with the proposed State Bank when the emergency of its establishment on official lines arose in 1927 So far as the Exchange Banks' are concerned with the usual statesmanship, which has characterized British enterprise outside Britain, differences were never allowed to become acute, and it would appear now that there is a very close and friendly understanding between the Imperial Bank and the foreign banks Whether such an alliance would seriously hamper the working of the Reserve Bank, when established remains to be seen" (*Minority Report* of Mr Manu Subedar, p 276)

The Imperial Bank has been acting as the banker of the foreign banks and has been financing them The difficulties of the foreign banks during the War necessitated co operation between the predecessors of the Imperial Bank and the foreign banks and the basis of co operation after that "has been the continued embarrassment of Government in the maintenance of their exchange policy The more frequent use of contraction for maintaining the exchange, and of a high bank rate, to support such contraction, and of extensive use of treasury bills to prevent remittance by Exchange Banks of funds in their hands, has brought down the foreign banks working in India and the Imperial Bank as Government Bankers, in much closer contact "

The Imperial Bank acts as agent of most of the foreign banks in the interior to collect bills, cheques etc , and it is interested in the working of the clearing house of which the majority of members are the foreign banks in many places There seems to be a close understanding between the Exchange

[11] *Minority Report of the Indian Banking Committee*, p 271

Banks and the Imperial Bank, "perhaps through the common nationality of the personnel"

The following table shows the figures of cash balances of the various banks with the Imperial Bank[12] —

(*In Lakhs of Rupees*)

Date	Exchange Banks	Indian Joint-Stock Banks
31st March, 1928	3,20	81
30th September, 1928	3,71	1,12
31st March, 1929	3,28	81
30th September, 1929	2,02	90
31st March, 1930	1,88	81
30th September, 1930	1,88	1,05

It shows that during the last two years the cash balances of the Exchange Banks with the Imperial Bank are falling heavily It seems "it had something to do with the practice of some foreign banks, who were paying in their cash into an overdraft account overnight, to the prejudice of the Imperial Bank"

Capital, Reserve, Deposits, Cash, Investments and Dividend of the Imperial Bank of India on 31st December each year from 1921[13]

(*In Lakhs of Rupees*)

Year	Paid up Capital	Rest and Reserve	Deposits: Total	Deposits: Public	Deposits: Private	Cash Balance	Invest ments	Dividend for the year per cent
1921	5,62	4,15	9,77	6,80	65,78	13,60	12,46	16
1922	5,63	4,33	9,96	14,16	57,00	15,07	9,79	16
1923	5,63	4,55	10,18	8,57	71,20	15,01	12,18	16
1924	5,63	4,80	10,43	7,50	76,71	15,60	16,37	16
1925	5,63	4,92	10,55	5,17	72,83	17,17	17,01	16
1926	5,63	5,09	10,72	6,45	73,90	20,90	19,15	16
1927	5,63	5,24	10,87	7,20	72,07	10,89	18,59	16
1928	5,63	5,39	11,02	7,95	71,30	10,58	21,76	16
1929	5,63	5,47	11,10	7,60	71 64	14,00	33,00	16
1930	5,62	5,53	11,15	7,37	76,60	13,04	29,25	16

The Indian Banking Committee have made the following suggestions to extend the activities of the Bank[14] —

---

[12] *Minority Report of the Indian Banking Committee*, p 276

[13] *Statistical Statements relating to Banks in India for* 1930 p 9

[14] *Report of the Indian Banking Committee*, p 368

"(i) It might use the indigenous bankers as agents for collection of cheques and bills in the same manner as it uses joint-stock or co operative banks (Paragraph 142)

(ii) It might discount the bills of indigenous bankers more freely than at present (Paragraph 144)

(iii) The assistance rendered to co-operative banks in the matter of cash credits and overdrafts against sound security should be continued (Paragraph 161)

(iv) It should grant to the co-operative banks remittance facilities for other than co operative purposes on the same terms as for joint-stock banks (Paragraph 182)

(v) It should continue to follow a liberal policy in the matter of granting advances against agricultural produce in godowns (Paragraph 185)

(vi) The existing practice of giving loans against gold ornaments should be further developed (Paragraph 252)

(vii) Within safe and proper limits it should extend the assistance at present given to industries on the lines followed by joint-stock banks in Germany (Paragraph 391)

(viii) Under conditions explained by us it should endeavour to take its proper place among the banks financing the foreign trade of India " (Paragraph 483)

IMPERIAL BANK AND THE RESERVE BANK BILL OF 1927

With the introduction of the Reserve Bank Bill in 1927, a Bill to amend the Imperial Bank of India was also introduced and the main features of the amending Bill of 1927 were as follows —

(1) The Imperial Bank was to act as the agent of the Reserve Bank in places where the latter had no branches

(2) The provision giving power to the Governor-General to issue instructions to the Bank was to be repealed

(3) The Bank was to be empowered to establish branches in India and elsewhere if it deemed fit

(4) The Central Board was to consist of (i) the President and Vice-Presidents of the Local Boards, (ii) a Managing Governor appointed by the Central Board (iii) a Deputy Managing Governor (iv) the Secretary of the Local Boards, and (v) such other persons to represent Local Boards as may be appointed by the Central Board The Deputy Managing Governor

was to vote in the absence of the Managing Governor The Secretaries of the Local Boards could take part in the deliberations, but had no power to vote

(5) The Bank was to give advances and grant cash credits on the security of debentures of Municipal Boards

(6) It was also to be empowered to open cash credits and give advances on the security of fully paid-up shares and debentures of limited liability companies in India and elsewhere

(7) The Bank was to be allowed to lend money on hypothecations instead of being restricted to make advances on the security of goods in its possession

(8) The Bank was to be allowed to deal in foreign exchange and the existing restrictions on the borrowing of money in England were to be abolished

(9) The Statement of the Bank was to be in conformity with the provisions of the Indian Companies Act and various administrative defects in connection with the working of the Bank were to be removed

In connection with the withdrawal of restrictions the Indian Banking Committee recommend that the Reserve Bank should have full discretion in selecting its agents and that it is preferable to use the Imperial Bank for agency business till some permanent arrangement could be made (Page 370 of the *Report*)

SPECIAL CHARTER

The question is whether after the establishment of the Reserve Bank, the Imperial Bank should have a charter of its own Two objections are urged against a special charter [15] Firstly, it is said that its position and prestige under the special charter would injure the interests of the joint-stock banks and secondly, it will be free from the obligations imposed upon

[15] See *Minority Report of the Indian Banking Committee*, p 279 Mr Manu Subedar writes, "With regard to the future position of the Imperial Bank, it is quite clear that when the Reserve Bank is established, the obligations of the Imperial Bank as government bankers must cease Various restrictions on its business must also cease If that is so, there is absolutely no reason, why there should be a special Act for it, and why it should not conform to the ordinary law of the country, and take its rank as the premier Indian Joint-Stock Bank It would be to the advantage of banking in India, if the Imperial Bank were to take this place and were thus to experience in an unsheltered and unprivileged position, the plight of joint-stock banks in India The authorities of the Imperial Bank would then throw in their weight to improve that plight, and seeking their own interests, they would also serve the interests of their class "

other banks by the Indian Companies Act The Indian Banking Committee have recommended that the special charter should continue and that the relevant Sections 132 and 136 of the Indian Companies Act should apply to the Imperial Bank also

With regard to the concession of granting certain interest-free balances to the Imperial Bank to encourage branch banking, it should be said that such facilities should apply equally to other joint stock banks The foreign experts who collaborated with the Indian Banking Committee objected to the provision of giving assistance to the Imperial Bank to open branches in the interior on a matter of principle but the Indian Banking Committee do not agree with this view and favour such concessions without involving preferential treatment to the Imperial Bank It was the question of preferential treatment to the Imperial Bank owing to which the provision relating to the grant of concession to the Bank was deleted by the Joint Select Committee of the Indian Legislature in 1927

An agreement is to be made with the Imperial Bank according to which the Bank will act as an agent for the Reserve Bank at all places where there is a branch of the Imperial Bank and no branch of the Banking Department of the Reserve Bank In the Bill of 1928 the period of agreement was 25 years, but the London Committee favoured 15 years The Select Committee on the Reserve Bank has fixed the period of future agreement at 15 years in the first instance But after that the agreement is not terminable unless five years' notice has been given on either side If the Imperial Bank fails to comply with the instructions given in matters affecting the safety of government balances or safety of currency chest balances in the custody of the Bank, the agreement is terminable The Imperial Bank will not reduce the existing number of branches during the currency of the agreement and in turn the Government would make to the Imperial Bank a fixed payment of nine lakhs a year and this subsidy will slowly disappear at the end of fifteen years

When the Reserve Bank is constituted it will take over government banking business at places at which it has offices, namely, Bombay, Calcutta, Delhi, Madras and Rangoon The work at present done by the Imperial Bank in respect of public debt at the public debt offices in Calcutta, Bombay and Madras will also be taken over by the Reserve Bank (For further details see the chapter on Reserve Bank)

Statement of Affairs of the Imperial Bank of India on the 23rd June, 1933 [16]

(000's are omitted.)

Liabilities	Rs	Assets	Rs
Subscribed Capital	11,25,00	Government Securities	37,53,35
Paid-up Capital	5,62,50	Other authorized securities under the Act	1,21,25
Reserve	5,17,50		
Public Deposits	7,81,39		
Other Deposits	72,99,14	Ways and Means Advances to Government of India	4,00,00
Loans against securities *per contra*		Loans	3,65,04
Loans from the Government of India under Section 20 of the Paper Currency Act, against inland bills discounted and purchased *per contra*		Cash Credits	18,83,63
		Inland bills discounted and purchased	2,89,54
		Foreign bills discounted and purchased	14,71
		Bullion	
		Dead Stock	2,62,45
Contingent liabilities		Liabilities of constituents for contingent liabilities *per contra*	
Sundries	1,73,67	Sundries	84,55
		Balances with other Banks	28,22
			72,02,73
		Cash	21,31,47
Rs	93,34,20	Rs	93,34,20

The above Balance-Sheet includes—

Deposits in London	£960,400	Percentage	25.82
Advances and investments in London	£945,300	Bank Rate	$3\frac{1}{2}$%
Cash and Balances at other banks in London	£913,900		

The items of the above statement require some explanation and the Liabilities side may be taken up first. Paid-up

[16] *The Indian Economist of Calcutta*, p. 502, July 3, 1933.

capital means that portion of the total capital which has been actually paid in cash by the shareholders and the credit of the Bank rests on it 'Reserve' means the reserve fund of the Bank which may be utilized in case of need 'Public Deposits' means the deposits of the Government on which the Bank has not to pay any interest and they increase when taxes etc, are paid in by people to the Bank 'Other Deposits' refers to the deposits made by the various classes of bankers in India, the Exchange Banks, corporations and traders and customers of the Bank in ordinary banking business with the Imperial Bank Usually when there is an increase in the 'Public Deposits' there is bound to be a decrease, though not to the same extent, in 'Other Deposits', because when people have got to make payments to the Government, they draw upon their bankers who in turn draw upon the Imperial Bank with the result that the Bank can only make a transfer entry decreasing the item 'Other Deposits' and increasing the item 'Public Deposits' thereby As the payment in some cases may be made directly to the Bank both the items need not be affected to the same extent Similarly when transfers are made by the Bank from 'Public Deposits' to 'Other Deposits' in the reverse circumstances the amount in the former item decreases while that in the latter increases The extent to which both these items are correspondingly affected by such transfers shows the strength of the Banking system The Imperial Bank of India pays interest on fixed deposits on sums not below Rs 500 and not on current account The Bank borrows money against some of its authorized securities included on the assets side and the amounts under these heads are known as 'Loans against securities *per contra*' 'Loans from the Government' under Section 20 of the Paper Currency Act refers to the amount borrowed by the Bank on the securities of internal bills of exchange and Hundis which is the method of giving elasticity to the currency system of India 'Sundries' means other liabilities of the Bank

On the Assets side Government securities denote the investments of the Bank in Government loans 'Other authorized securities' means those securities in which the Bank can invest money according to the Act It refers to the securities of the State aided and District Board Railways and to those of the Port Trusts, Municipalities and Improvement Trusts 'Ways and Means Advances to the Government of India' means the money lent to the Government for ways and means 'Loans and Cash Credits' refer to the advances made by the Bank to its customers on securities deposited by them with the Bank 'Bills Discounted, Foreign and Inland' means the bills of exchange purchased by the Bank 'Bullion' means the gold and silver stock held by the Bank

CHAPTER V

Indigenous Banking

It is not easy to define the term 'Indigenous Banker' "Whoever coined the words 'Indigenous Banker' has not done service to India The word indigenous is a direct contrast of 'foreign' There have been foreign banks in India but Providence has been kind that there have not been foreign bankers doing work, which the indigenous bankers are doing The designation is not a happy one Nor is it a correct description Nor does it help in the classification'[1] The Provincial Banking Committee Reports have fully described the various types of bankers and money-lenders engaged in a large variety of functions relating to agriculture, trade and general banking Dr Jain defines indigenous banker as 'any individual or private firm which, in addition to making loans, either receives deposits, or deals in Hundis, or both, each of which functions clearly belongs to banking'[2] It is difficult to assign any special functions performed by this great heterogeneous class They perform different functions in different provinces according to the financial and economic needs[3] The indigenous banker is known by various names—the Bania, the Sowkar, the Mahajan, the Shroff and the like and different castes carry on the business in different provinces—the Marwaris and the Multanis of Bombay, the Chetties and Nattukottai Chetties of South India the Khatris and Aroras of the Punjab and the Multanis and Rehtis of Sind and Gujrat, etc

HISTORICAL RETPOSPECT

Indigenous banking exist... India even in Vedic times when rates of interest were r...y to th...ut loans were made generally to the poor and the ...abilities o... third, fourth and fifth centuries A D deposit ba...ment secura was developed and bankers then understood ...overnment the fluctuations of money value charged intere...e securinsurances by land and sea, granted Bs/E and follo... most of the practices of modern banks[4] No accurate account is available of their functions and existence in the Middle Ages, but still it can be shown that indigenous banking flourished in those times In

---

[1] *Minority Report of the Central Banking Enquiry Committee*, p 100

[2] *Indigenous Banking in India*, by Dr L C Jain, p 3

[3] *Majority Report of the Central Banking Enquiry Committee*, pp 95 98

[4] *Indigenous Banking in India*, by Dr L C Jain, p 8

the reign of Feroz Shah (1351-88) the bankers of Sarsuti lent large sums of money to the king which were used for making payments to the army Indigenous banking was highly developed in Moghul times for we know that an orthodox Muslim Emperor like Aurangzeb honoured Manik Chand, the eminent banker of that time, with the title of Seth and his nephew Fateh Chand, an eminent banker of Murshidabad, was given the title of Jagat Seth or world banker by Emperor Farukhshiyar in recognition of the monetary help given to the Emperor in his campaign against Emperor Manzoo Deen These bankers occupied an important place in the banking system of India even in the days of the English East India Company and this is evidenced by the fact that Lord Clive entertained Jagat Seth for 4 days at a cost of Rs 17,373

In those days their functions were very important They financed the foreign and the internal trade of India and derived a lot of profit from this source They lent money to the Emperors and the Nawabs generally and specially during the wars on personal security at fairly high rates of interest Revenue collection was done through the indigenous bankers They made themselves responsible for paying land revenue on behalf of the cultivators and received grain from cultivators in lieu of their paying revenue on behalf of cultivators Money changing business was another important function which they performed During the period beginning with the reign of Akbar up to the time of Bahadur II, the number of mints was about 200 and in Aurangzeb's reign alone there were no less than 70 mints manufacturing coins Towards the end of the Moghul period there was a bewildering collection of coins, some of them of the same denomination bearing different dates and circulating at varying values in different portions of the country To change one kind of coin for another was an important service performed by these bankers An average man knew very little about the fluctuations in the rate of exchange in which function, the bankers specialised themselves

The fall of the Moghul Empire was followed by a period of internecine wars and political disruption in India At such a time trade and industry could not have flourished and so was the case with banking But to carry on these wars money must have been required and the services of the money changers and bankers must have been necessary At the same time with decline in trade, the indigenous banking system must have received a set-back

With the establishment of the rule of the East India Company, the European merchants and the English agency houses in India began to finance foreign trade, for it was mainly in their hands and the currency reform of 1835 introduced by the

British Administration which adopted the present rupee for the whole of India caused a curtailment of the functions of indigenous bankers

The effect of early European banking institutions in India upon the indigenous bankers was thus unfavourable to the latter which maintained a separate existence from the former The European Houses began to finance foreign trade and the indigenous banker financed the agriculture industry the cottage industries and the internal trade The two kept apart and no effort was made to co-ordinate them although later on the indigenous bankers found it profitable to increase their resources by resorting to borrowing occasionally from the presidency banks and the joint stock banks

PRESENT FUNCTIONS

The functions of an indigenous money lender consist in making advances in the form of money, corn, seeds or cattle to agriculturists on the security of the produce or movable or immovable property or on personal security also The indigenous banker on the other hand carries on the functions of money lending deposit receiving on current or fixed deposit accounts allowing cash credits and dealing in bills of exchange or Hundis of both kinds—demand and usance But these functions are performed by a modern bank also running on Western lines There is a lot of difference nonetheless between the functions of indigenous bankers and those of a modern bank All indigenous bankers do not receive deposits and even if they receive them such deposits form a very small portion of their total resources But a modern bank on the other hand, raises its working capital mostly through deposits The withdrawals allowed by the indigenous bankers against deposits are mostly in the form of cash and not by cheque which is the case with modern banks Some indigenous bankers, however do issue cheque books in vernaculars which have a very narrow circulation A modern bank provides a cheap currency in the form of deposits subject to cheques and thus helps to bring about elasticity to the currency system and helps in stabilizing the price level The indigenous bankers rarely resort to issuing cheques and do not, therefore, give the benefit of providing a cheap circulating medium The indigenous banker does not confine himself exclusively to banking business proper as a modern bank does but carries on certain other business also which does not properly speaking fall under the province of modern banks The other business which indigenous bankers carry on is industry, trade and commerce They act as grain dealers general merchants commission agents, brokers traders, industrialists, jewellers etc The business of money-lending and deposit receiving occupies a secondary place

with the indigenous bankers This tendency is more pronounced in recent years owing to the fact that they have been losing ground in banking business because of their antiquated methods, unification of the modern currency system provision of cheap and safe remittance facilities and the rise of co-operative societies They also carry on speculative dealings in stocks and shares in Bombay Stock and Share Market This is not the business of a scientific banker who should avoid speculation under all cases The indigenous bankers do not fear a run from their customers because they do not raise deposits to a great extent They allow loans on the security of land, buildings, ornaments, and the like and do not realize the enormous difference between a B/E and a mortgage' They do not keep their assets in a liquid form and do not suffer thereby because they deal with their own money They do very little to promote banking habit which is done by modern banks The creation of banking habit is very necessary for the economic development of a country Promotion of thrift can be inculcated by receiving deposits on interest and as indigenous bankers do not do so, they fail in achieving this object

The importance of these differences should not be exaggerated and the services rendered by indigenous bankers should not be minimised Their services in financing agriculture, cottage industries and internal trade are of immense importance to India

Nature, Extent and Methods of Business

The operations of the indigenous bankers are not attended with formalities and delays Their accounts are kept in a simple and economical way, though they are accurate and efficient Their establishment is not costly and they are easily accessible They receive no regular banking education except that which is picked up in the regular course of business, and from past experience of their firms

The indigenous bankers cannot establish direct relations with cultivators and they finance agriculture through local Sahukars and money-lenders In Burma the Chettiyar sends out his clerks to the villages to deal with local borrowers and in Bihar the indigenous banker lends to grain merchants and advances directly to zamindars who have an easy access to towns He also indirectly finances agriculture by financing internal trade He has ceased to advance money against land in provinces where Land Alienation Acts are in force

The indigenous banker maintains a close personal touch with the trader and the small industrialist He does a lot of general banking business in this connection, such as buying and selling remittance, discounting Hundis, receiving deposits and granting loans against stock-in-trade The majority of

the indigenous bankers combine banking with trade and because of competition from joint-stock banks, their banking business has declined and they have tried to make up this lost ground by developing trading activities Their banking business has also declined for the following reasons

(a) Loss of agency business in Hundis because the exporting firms have established their own branches

(b) Heavy stamp duties on bills which have restricted their bill business

(c) Temptation for speculation which they can fulfil in trade and not in banking

There are three kinds of indigenous bankers at present· (1) Those whose principal business is banking, (2) those whose principal business is trading but who employ surplus funds in banking business also and (3) those who are both traders and bankers

Relations with Organized Banking Institutions

No authoritative statistics are available with regard to the business done by the indigenous bankers We have seen that the financing of agricultural industry the cottage industries and the financing of internal trade largely falls to the share of indigenous bankers The total agricultural indebtedness in India is about Rs 900 crores and the Hundis discounted or rediscounted by the Imperial Bank even in the busiest season never exceed Rs 12 crores Thus the part played by the indigenous bankers in financing trade and industry is very considerable

Internal trade is also financed by the joint-stock banks and indigenous bankers are to a certain extent dependent upon them The joint-stock banks keep an approved list of the indigenous bankers with whom they carry on business Every banker on the list is assigned a certain amount of credit determined by his financial position and he will not be allowed credit more than this amount The joint-stock banks will refuse to discount the Hundis endorsed by the indigenous bankers if they exceed this limit though, as a rule this limit is seldom exceeded as the indigenous bankers prefer to invest their own funds rather than endorsing the Hundis and rediscounting them with joint-stock banks It is only in the busy season that they borrow funds from the joint stock banks for at that time their own funds are less than the accommodation required by the traders At such a time the customers' Hundis are endorsed and taken to the joint-stock banks which readily

* *Central Banking Enquiry Committee Report*, p 90

discount them according to the standing of the banker concerned The banker refuses to accept too many Hundis of the same customer in order to be on the safe side The joint-stock banks do not take the Hundis directly from the traders without the indigenous bankers' endorsement, for in that case the Hundis would have behind them only the personal security of the traders, but with the Shroff's endorsement the security is enhanced

Relations of Indigenous Bankers to the Imperial Bank

The Imperial Bank of India provides the following facilities for the Indigenous Bankers (1) It provides remittance facilities for transfer of funds from one branch to another The branches to which funds are transferred are enabled to purchase the Hundis endorsed by the indigenous bankers or one branch is in a position to issue demand drafts and telegraphic transfers upon another to which money is transferred (2) Another facility is that the Imperial Bank in the busy season grants accommodation to the indigenous bankers by rediscounting the Hundis endorsed by them Such endorsement is essential to satisfy the provision of the Imperial Bank Act according to which the Imperial Bank cannot rediscount a Hundi unless it bears two independent names Section 20 of Act X of 1923 as amended in 1924 authorizes the Imperial Bank to borrow emergency currency from the Paper Currency Reserve in busy season to the extent of Rs 12 crores and to advance it on the security of self-liquidating Hundis The Bank has, however, found it difficult to get Hundis, for the indigenous bankers want cash credits Formerly these facilities were not taken advantage of because of the high rate at which emergency currency was issued by the Government to the Imperial Bank In 1924 the minimum rate was reduced to 6 per cent for the first 4 crores, 7 per cent for the second and 8 per cent for the next four crores This was the minimum, but the loans were to be at the current bank rate Later on, the scale was reduced further, but still the amount of genuine Hundis coming to the Imperial Bank does not usually exceed 5 or 6 crores

Trade Bills are not available in large numbers mainly for two reasons Firstly, the current methods of internal trade do not provide scope for trade bills to be drawn and sold in the villages Secondly, people who can draw them have no training in their creation and discounting

The connection of indigenous banks with the clearing house system is practically nil, and they are not members of the clearing house system mainly because the cheques passing

through them are not of sufficient amount to justify their becoming members of the system The number of cheques drawn on them is small and such cheques are collected by a branch of the Imperial Bank or a joint-stock bank But if no branch of the Imperial Bank or of a joint-stock bank is there at such a place where the drawee indigenous banker resides, the latter makes payment either by cheques on a clearing banker or in cash

Defects of Indigenous Banking

The chief defect of indigenous banking is that it hardly constitutes banking in the proper sense of the word It has comparatively little of deposit and discount business and is confined mostly to money-lending business This money-lending business has in itself several unfortunate concomitants such as extortionately high rates of interest, usurious compound interest rates and dishonest dealings on the part of money-lenders All these evils have very unfortunate economic consequences to the borrowers and to the country as a whole Lack of deposit banking is also responsible for the prevalence of hoarding habit People may disagree on the amount of hoards, but the fact that they do exist is an established one and this is responsible for a lot of economic waste So much capital productively employed must go a long way to improve the economic condition of the people of our country Most of the people of India being illiterate cannot understand the methods of modern banks on European lines having their accounts in a foreign language Indigenous bankers know very well their customers and can inspire confidence into them and are also easily accessible to them It is only these bankers who can do much in creating banking habit among the people of this country

Absence of a native discount market is another defect of indigenous banking The discounting of Hundis plays a very small part in the financing of trade and industry as compared with the use of cash employed for the purpose This involves transfer and retransfer of funds from one place to another which is wasteful and uneconomical Moreover this fact is responsible for lack of any effective and important connection between the indigenous banks and the joint-stock banks Another defect is that the indigenous banking system neither controls nor is controlled by joint-stock banks There is no effective leadership in the Indian money market The indigenous bankers work more or less as independent units In busy times, the indigenous bankers do approach the joint-stock banks for accommodation but for the most part of the year the bazar rates are not determined by the Bank Hundi rate In the slack season the bazar rate may be lower than the Hundi rate as the indigenous bankers have surplus funds and

can underquote the joint-stock banks. Further, the indigenous bankers in the slack season have high reserves with them because they do not deposit them with the joint-stock banks and in busy season, they have to seek the help of the joint-stock banks and the result is that they have to keep unduly high reserves with them at one time and very little at another time. The joint-stock banks also have to maintain high reserves owing to the lack of a central banking institution.

LINKING THE INDIGENOUS BANKER WITH THE GENERAL BANKING SYSTEM

The next question naturally arises as to how these defects are to be removed. It is clear that unless some connection and close relation is established between the indigenous banks and other banks, situation cannot improve. The Bazar and the Bank operations must be correlated in some systematic way. Another line along which reform should go is that the method of cash credits should be replaced by trade bills, but in any case the change will be very slow and the illiteracy of the population will stand in the way to a very great extent. The question is, "How should the indigenous bankers and the money-lenders be linked to the Indian joint-stock banks through the development of an indigenous bill market that both may respond to the policy of a Central Bank?" Dr. Jain suggests that there should be a closer contact between the joint-stock banks and the indigenous banks by developing the functions of the endorsing shroff. This can be done if the joint-stock banks increase their branches which is not in their interests very soon because they must co-ordinate their position first. The indigenous banks must change their existing methods and take up those functions which the discounting houses perform in England. New indigenous banks on joint-stock lines must be formed to receive deposits, discount bills and issue cheques. People will be able to entrust their savings to them because they will inspire confidence into them. The advantages of this reform will be that loans will be made at lower rates, for more capital will be available. Of course, they will have to discriminate between productive and unproductive debts and between spendthrifts and the thrifty. Thus, they will be able to grant loans for productive purposes and will discourage borrowing for unproductive purposes. They will also encourage the creation of commercial paper which they will readily discount.

This new system will be helpful to the co-operative societies as well. These amalgamations will be of those houses which now compete with co-operative societies and they will rediscount commercial paper endorsed by the co-operative societies. The latter will thus be able to finance their honest customers by endorsing the latter's Bs/E. Joint-stock banks

also will gain, for commercial paper will be created for being rediscounted with them Indigenous bankers will always be able to meet any demands of their customers and joint-stock banks will get good paper to invest their money in The new indigenous banks will supply the missing link between the modern money market and the indigenous money market by providing an open market in indigenous bills for the Central Bank which will be able to function as a bankers' bank

PROPOSALS OF PROVINCIAL BANKING COMMITTEES

The Provincial Banking Committees suggested the following ways to link the indigenous banking system with other banks —(1) Indigenous bankers should be linked with the central banking institution of the country as its agents in those places where no other banking organization exists Certain restrictions should be imposed upon such indigenous banks in order to avoid risks of speculation (2) Indigenous bankers who satisfy certain conditions should be treated as member banks on the approved list of the Reserve Bank when created and they should be required to keep a certain amount of their deposits with the Reserve Bank and should get the same facilities for rediscounting commercial paper as other member banks subject to certain restrictions (3) Commercial banks including the Imperial Bank should discount the bills of indigenous banks more freely At present, there is a complaint against the Imperial Bank that its local branches in some places refuse to rediscount Hundis bearing the endorsement of even the firms of highest repute[6] (4) Indigenous bankers should re-organize themselves on modern lines to inspire public confidence and the Government should encourage re organization by appointing such institutions when formed to be government bankers (5) A class of licensed bankers should be created which should get certain privileges in return for certain obligations The privileges should be special facilities for recovering their money from their debtors, their rates of interest should not be changed under certain conditions, the Imperial Bank should not open a branch where the licensed indigenous banker is working, facilities for remitting funds through the Imperial Bank and grant of rediscounting facilities by the Reserve Bank should be on the same terms as those enjoyed by the joint-stock banks[7]

PROPOSALS OF THE CENTRAL BANKING ENQUIRY COMMITTEE

The Central Banking Enquiry Committee, after careful consideration of the various proposals, have come to the conclusion that some action should be taken to improve the

---

[6] Bengal Committee Report quoted on page 105, *Central Banking Enquiry Committee Report*

[7] *Central Banking Enquiry Committee Report*, pp 106, 107

position of indigenous banking in India and that the indigenous banker should be made a useful member of the Indian Banking System. The indigenous bankers' rates of interest do not compare unfavourably with those of ordinary joint stock banks and their advantages to Indian commercial community are greater than those of joint-stock banks, but the indigenous bankers have fallen on evil days. In the interests of agriculture, finance and trade of the country some action is necessary. Agriculturists, merchants, traders and small industrialists mostly depend for financial help upon the indigenous banker even in places where other types of banks exist. Joint-stock banks will take a fairly long time before they can do enough work for Indian economic development. The extension of the co-operative movement on such a scale as to replace the indigenous bankers is not possible in the visible future. The Imperial Bank of India is not likely to spread its net-work of branches to a greater extent because many of its existing branches have not yet reached a profit-making stage. In view of the above reasons, the Committee make the following proposals without involving any compulsory measures :—

(1) The indigenous banker should be brought into direct relations with the Reserve Bank as soon as it is established and rediscounting facilities should be provided for such indigenous bankers as come into direct relationship with the Reserve Bank. Indigenous bankers who do only proper banking business and are prepared to shed their other business should be put on the approved list of the Reserve Bank and some standard of capital should be fixed which an indigenous banker must satisfy before he can be given the required concession. (2) Such of the indigenous bankers whose deposits do not exceed five times their capital, should, during the first five years of the working of the Reserve Bank, be exempt from the rule relating to compulsory deposits and at the end of the period the Reserve Bank may take such action as it deems proper to make its credit policy effective.[8] (3) No condition should be imposed as to the maximum rate of interest to be charged by these banks in return for

---

[8] Ordinary member banks should maintain a certain percentage of their time and demand liabilities as interest-free balances with the Reserve Bank, but the Committee have not insisted on such a rule being imposed in connection with indigenous bankers for the following reasons. (1) The object of such compulsory deposits is to enable the Reserve Bank to control the credit policy of the member banks, but so far as indigenous bankers in general are concerned, their deposits and operations though large in the aggregate are individually small and, therefore, the principle of compulsory deposits cannot apply to them with as much force as it can in case of other banks. (2) Small indigenous bankers cannot furnish the necessary returns for the observance of this rule. (3) The principle of compulsory deposits will not attract the indigenous bankers to come into the sphere of the Reserve Bank System. (*Central Banking Enquiry Committee Report*, p. 108.)

the facilities offered, but the Reserve Bank should be given the power to see that institutions receiving rediscount facilities from it do not charge unduly high rates of interest from the public (4) The same remittance facilities should be given to these banks as are given to all joint-stock banks by the Imperial Bank of India or the Reserve Bank when the latter is established (5) The Imperial Bank should adopt a more liberal policy for providing banking facilities to indigenous bankers (6) An Association of All-India Banks and Bankers should be formed as early as possible and such indigenous bankers whose bills the Reserve Bank decides to accept should become full members of the All-India Bankers' Association This will raise their status and improve their banking methods (7) Local indigenous bankers should form themselves into joint stock banks (8) 'Kommandit principle banks of the German type should be established in India (9) A co-operative bank of indigenous bankers should be formed to discount the Hundis of member banks and it can rediscount the same with the Reserve Bank And (10) Bill broking should be adopted as an integral part of the indigenous bankers' business

The indigenous bankers should themselves carry out these reforms and the Committee "are of the opinion that if they bring their system of operations more into line with the custom and practices of commercial banks in the matter of audit and accounts use of bills and cheques prompt payment and receipt of moneys and conduct of business strictly in accordance with legal requirements, they will take their proper place in the banking system of the country '

Mr Ramdas Pantulu in his *Minute of Dissent* wants action to be taken beyond the recommendations of the *Majority Report* He says, " that the question of placing the indigenous banking system as a whole on sound, stable and solid modern foundations cannot be satisfactorily solved by the mere provision of facilities, however valuable they may be to individual private bankers, selected for special treatment by the Reserve Bank or the Imperial Bank There is too much of personal element in it and too little of the system The success of the scheme must in the long run depend not upon the survival of a few individual bankers to take advantage of it but upon the reorganization of the indigenous banking classes so as to bring them into the banking system of India " (*Central Banking Committee Report*, p 523) The establishment of the Reserve Bank and the creation of a privileged class of indigenous bankers getting certain facilities from that bank and being used as agents for collection of its cheques and bills will no doubt bring them more into contact with other banks but merely this will not develop indigenous banking system as a whole These

bankers have great resources which are available for the economic development of the country and they still provide the bulk of the capital of all the credit agencies put together They should, therefore, be fully utilized to fit into the modern banking system which is being developed in the rural areas If the government changes its short-term borrowing policy, their dwindling resources will be repleted The indigenous bankers have plenty of traditional knowledge and skill and are known for their honesty, business dealings, resourcefulness and aptitude for saving money Some of them work largely on modern lines and do all kinds of business which the commercial banks do, as issuing pass books and cheque books and they meet the requirements of the commercial classes '

Mr Pantulu recommends that those indigenous bankers who carry on pure banking business should be conferred the legal status of a banker and should be brought within the scope of the Bank Act recommended by the Banking Committee "It should not surely be difficult to fix standards of eligibility for registration as bankers and to frame a set of banking regulations which are suitable to the peculiar conditions of such partnerships and bankers ' In order to impart vigour and tone to the indigenous banking system the indigenous bankers should be put on a statutory footing by registering all those who wish to avail themselves of the provision of the Bank Act The Act of registration will confer a status and dignity upon them and there is no reason, therefore, for their disliking the idea of registration Lawyers, doctors, engineers and other professional men get themselves registered and registration in the case of indigenous bankers also should not be a 'writ of restraints, but a charter of rights The leaders of the indigenous bankers can popularise this idea and they should be impressed that if they refuse to become serviceable in establishing a money market in the country, they will be excluded from the national economy of the country

With regard to what they will get in return for registration, it may be said that "the very fact that they carry out banking as recognized bankers and submit themselves to regulations which are framed to protect the interests of depositors and to ensure the adoption of efficient business methods will inspire confidence in the public and will enlarge their resources and expand their business" Their position as bankers under the law will entitle them to get the same privileges as will be conferred upon joint-stock banks They will be able to receive money into their counters without stamping receipts, will have remittance and collection facilities open to other

---

[9] *Central Banking Enquiry Committee Report, Minute of Dissent*, by Ramdas Pantulu, p 325

banks, but not open to the public and the more important of them may claim the membership of clearing houses The Banker's Lien should be extended to them and the provision of the Baukers' Books Evidence Act can also be applied in their case If other banks get any facilities for speedy determination of their claims or reduction in costs of litigation, the registered indigenous bankers also may have them and they will get discount and rediscount facilities The Imperial Bank will choose for its agency work for collection only the registered indigenous bankers and the associations of the registered indigenous bankers will then 'have a wider influence and higher prestige than those of a nebulous class' In this way the whole of the indigenous banking system will be given a new orientation

The multiplication of sound joint stock banking system and the spread of the credit co-operative movement is bound to take time and reconstructing indigenous banking on modern lines will be more helpful than the displacement of the system Development of banking in India cannot be achieved by a "mere slavish imitation of the English Joint-Stock Banks' Model" which is very expensive and extravagant standards of banking establishments set up by foreign bankers and copied by Indian joint stock banks are unsuitable for India Lofty and spacious halls with shining counters are not the things to copy It is the really vital and progressive features of the English banking system that need emulation and the indigenous banking system if put on modern lines can achieve the object, for their methods are very economical

The savings of people collected as deposits by commercial banks are taken to urban centres and the postal savings with the government also starve the local needs The rural areas suffer for want of funds and indigenous bankers in this respect can supplement the activities of the co-operative banks The evils of uncontrolled money lending are increasing and the indigenous bankers finance to a very great extent the trade and industries of the country, but at onerous rates of interest which must be brought under proper control The operations of the indigenous bankers lie outside the influence of the organized banking system of the country and as the indigenous bankers do not place their idle funds with other modern banks in India, they are outside the sphere of the money market In order to provide for the extension of a bill market in India and to provide effective control over the credit operations of the indigenous bankers for the central banking authority when it is set up, the indigenous bankers must be modernized

CHAPTER VI

Co-operative Movement

THE success of the small village banks in Germany towards the close of the last century attracted the attention of those who were eager to solve the problem of rural poverty. Sir Frederick Nicholson was deputed by the Madras Government to study the system and his report was published in two parts in 1895 and 1897. In the U.P. and the Punjab societies began to be organized by Mr Dupernex and Mr Maclagan respectively, which at that time could be registered under the Company Law. The Famine Commission of 1901 advocated the formation of mutual credit associations. In 1904 the Co-operative Credit Societies Act was passed in India.[1] Three points about the new policy deserve to be mentioned. Firstly, the application of the Act to credit co-operation only was deliberately decided upon which proved to be wise. The Act was framed before there was any experience of the movement in India and it was good that only one line was selected. Secondly, the movement was not the outcome of any popular demand but the new legislation like that in Japan was the result of the desire of the Government to ameliorate the economic conditions in rural India. Public-spirited helpers had to be found and encouraged to come forward and undertake responsibilities. Thirdly, the establishment of a Government department in charge of the movement was inevitable.

---

[1] Main provisions of the Act were as below:—

(a) Any ten major persons belonging to the same village, tribe, caste or town could apply for registration as a society.

(b) It made provision only for credit co-operation.

(c) Societies were to be rural and urban according as four-fifths of their members were agriculturists or not.

(d) Unlimited liability was the rule in the case of a rural society and in the case of the urban societies the matter was left to their choice.

(e) All the profits of a rural society were to be credited to a reserve fund.

(f) Certain limits were imposed upon the size of the share capital and no member was to hold more than one-fifth of the shares and the total value of an individual member's share could not exceed Rs. 4,000 nor could he have more than one vote.

(g) Registrars were to be appointed in all provinces to exercise supervision.

(h) Government reserved certain powers for themselves as compulsory inspection, audit, dissolution, etc.

The Government thus having no co operative experience in India to guide it had to depend upon its official staff to carry out its policy These special features have influenced the movement throughout its later course and also explain many later developments [2]

The original Act made no provision for non credit societies or for the higher finance of the movement for two reasons Firstly, the crushing burden of agrarian indebtedness in India makes it very difficult for agriculturists to "lend a willing ear to the advice of the agricultural expert and secondly, a good credit society has an immense educative value on which the foundation of more ambitious schemes can be laid down It affords an excellent training in the handling of money in expending it on productive purposes, and in the elements that combine to build up sound credit It readily lends itself to organization for mutual help throughout the country side, and, wisely guided it encourages and stimulates the practice of thrift and illustrates vividly the advantages of even the smallest savings when they are made regularly over a series of years ' These two omissions were supplied by the second Act of 1912 which is still in force throughout the country except in Bombay and Burma where local legislation was passed in 1925 and 1927 respectively

PRESENT POSITION

Certain recent statistics relating to the movement in India are given below[3] —

AGRICULTURAL CO OPERATIVE SOCIETIES

Year	Credit			Non Credit		
	No of societies	No of members	Working capital Rs in lakhs	No of societies	No of members	Working capital Rs in lakhs
1915–16	16 690	665,527	4,92	96	4 822	1
1916–17	19,463	723,329	5,65	160	7 186	1
1917–18	21,688	767,265	6,36	249	13,944	5
1918–19	26,214	864,500	7 34	437	24,237	13
1919–20	32,595	1,046 839	8,73	616	34,057	18
1920–21	37,673	1,204 199	10,60	857	50,212	21
1921–22	41 516	1,347,277	12,08	1,073	62,984	30
1922–23	45,043	1,442,080	13,47	937	57,320	32
1923–24	49,118	1,585,708	15,15	1,196	77,686	40
1924–25	54,390	1 749,196	17,59	1 595	99,694	49
1925–26	59,018	1,901,529	20 47	1,769	121,789	54
1926–27	65 101	2,115,746	24,14	2,133	154,322	58

[2] See *Agricultural Commission s Report*, pp 444, 445, paras 370 and 371

[3] This table has been taken from the *Report of the Royal Commission on Agriculture in India*, p 446

The following table shows the extent to which the rural population in different provinces has been touched by the movement[4] —

Province	No of members in all agricultural societies 1926 27	No of members in agricultural credit societies 1926-27	Rural population (census of 1921) in 000 s	No of rural families in 000's	Proportion of members of Agricultural Societies to families in rural areas: All societies per cent	Credit societies per cent
Ajmer-Merwara	10,185	9,879	330	66	15 4	15 0
Assam	12,478	42,478	7,428	1,186	2 9	2 9
Bengal	380,562	329,765	43,509	8 702	4 4	3 8
Bihar & Orissa	205,825	205,000	32,627	6,525	3 2	3 1
Bombay	300,077	260,182	14,908	2,981	10 0	8 7
Burma	93,161	87,417	11,921	2,384	3 9	3 7
C P & Berar	59,459	58,039	12,519	2,504	2 4	2 3
Coorg	11,223	11,223	155	31	36 2	36 2
Delhi	1 250	1,250	184	37	11 5	11 5
Madras	612,220	583,315	37,040	7,408	8 3	7 9
N W F P	681	681	1,915	383	0 2	0 2
Punjab	401,512	373,155	18,473	3,694	10 9	10 2
United Provinces	148,405	148,332	40,570	8,114	1 8	1 8

The table shows that leaving out the Punjab, Bombay and Madras, the movement in other provinces has touched only a fringe of the population

"The main results achieved may be said to be the provision of a large amount of capital at reasonable rates of interest and the organization of a system of rural credit which, carefully fostered, may yet relieve the cultivator of that burden of usury which he has borne so patiently throughout the ages Knowledge of the co operative system is now wide spread, thrift is being encouraged, training in the handling of money and in elementary banking practice is being given Where the co-operative movement is strongly established, there has been a general lowering of the rate of interest charged by money-lenders, the hold of the money-lender has been loosened, with the result that a marked change has been brought about in the outlook of the people" Thrift has been inculcated and this too is a noteworthy achievement At the end of June 1930 about 20 lakhs of members had a share capital and reserve amounting to about Rs 8 crores and deposits amounting to Rs 2½ crores and the total working capital amounted to about Rs 30½ crores

At the end of June 30, 1932, for the U P the number of Central Banks and non-credit central societies came to 85,

[4] *Report of the Royal Commission on Agriculture in India*, page 447

total membership consisting of individuals and societies was 6,611 and 5,160 respectively, total lendings during the year to individuals were Rs 1,37,115 from Central Banks and Rs 1,64,616 from primary societies. The figures for agricultural societies were[5]

No of societies	No of members	Loans to members	Deposits	Working Capital	Owned Capital
		Rs	Rs	Rs	Rs
5,418	1,17,176	20,93,159	11,17,541	1,01,94,902	52,92,701

The position of non agricultural societies for the year was

301	29,932	23,30,812	15,70,973	29,36,337	11,95,128

The Primary Societies

The primary societies form the basis of the financial structure of credit co-operation. They are associations of borrowers and non-borrowers of the same locality. They know one another very well and this factor fosters a spirit of co-operation and self-help among them. The foreign banking experts recommended that the membership of primary societies should not be confined to a special creed, caste or calling or to a certain class of people resident in a locality. The rural societies are usually unlimited liability societies based on the Raiffeisen model, the famous German co-operator. An inhabitant of a village of good character can become a member. The tangible assets of the society consist of the property of the members whose details are entered in a list called the Property Statement of the society which is revised from time to time to make it up to date. In some provinces, specially the Punjab, the United Provinces, Madras and Burma, share capital plays an important part whereas in other provinces the share and non-share societies exist side by side. The Central Banking Committee are "of the opinion that the encouragement of subscription to share capital by members as a method of collection of savings is to be preferred to a system of compulsory deposits." These societies raise capital locally on the combined liability of members to be lent out to the latter. Their resources are supplemented from deposits from members and loans from outside. Under existing circumstances primary societies should not attract deposits from non-members at high rates of interest, because this will not bring down the rates of interest. Further non-members' deposits cannot be profitably utilized without an efficient and well-organized Central Banking system which can act as a true balancing centre for primary societies. The societies should attract deposits from members and thus promote a

[5] These figures are taken from the *Annual Report on the Working of Co-operation in U P for* 1931–32, pp 2A to 15A in Appendices.

habit of thrift The urban societies are modelled on the Luzzati type in Italy and Schulze Delitsch type in Germany on unlimited liability basis In connection with loans the primary societies should follow the principles given below —

(1) The maximum borrowing capacity of a society from a central bank should be fixed on some basis as so much fraction of the net assets of the members

(2) No loans should be advanced for wasteful purposes and scrutiny of the purpose of the loan should be made by the Managing Committee

(3) In fixing the borrowing power of the individual fair latitude regarding his needs should be allowed

(4) The members should keep mutual watch over one another

(5) The instalments of repayments of loans should be fixed with due regard to the repaying capacity of the borrower

(6) The principle of "one man, one vote" is generally observed universally and there are restrictions on the transferability of shares

(7) The society has a prior claim subject to the dues of the Government over other creditors of the members in the matter of enforcing outstanding demands In Bombay the prior claim is converted into a first charge under the Local Act and the same should be done in other provinces

(8) The societies are under statutory obligation to build reserve funds according to Section 33 of the Act In share societies profits cannot be distributed unless 25 per cent is carried to the reserve fund In some societies in the U P the practice is to lend money to members out of the reserve fund, the reason being that the central banks pay a low rate of interest on the reserve fund to societies, while the rate charged on loans is much higher The central banks should lend to societies at concession rates sums up to the extent of the reserve funds of the latter

THE CENTRAL BANKS

The central banks are higher financing agencies to lend money to primary societies, and they co-ordinate and guide the activities of the societies Their membership consists of primary societies and individuals Their resources consist of owned capital, i e, share capital and reserve funds, deposits

of various kinds, surplus funds of primary societies and deposits from municipalities, university and local bodies in many cases Central banks should start a bad debt fund to strengthen their financial position

Provincial Banks

The provincial banks are still higher financing agencies to act as balancing centres for the central banks, to remove the excesses and deficiencies of money in different parts of a province and to transfer money from one place to another They derive their funds in the same way as central banks do and many of them enjoy cash credits and overdrafts arrangements with the Imperial Bank and with other joint stock banks and they also get short term and call money from the latter The Indian Provincial Co operative Banks' Association co ordinates their activities and supplies information to them about the financial requirements of banks The provincial banks lend money to central banks, the latter to the societies and the societies to the individuals The idea is that the money should be distributed among numerous cultivators who need help, "thinning out the stream of the water collected, sending it in rills over a broad surface, so that irrigation may be perfect and reaching every root to be watered "[6]

The question of an All India Co operative Bank was considered and its establishment was recommended by the Maclagan Committee, but now there is no necessity of it Co operation is a provincial subject and every province can devise legislation in this respect to suit its special conditions Moreover, the Imperial Bank can easily grant the required accommodation to the provincial banks with whom funds usually lie idle to a great extent When the Reserve Bank is established, the necessity of an all-India Co operative Bank will be nil There is no provincial co operative bank in the U P where one should be established as soon as possible This was recommended by the Oakden Committee and by the U P Banking Committee also

Defects in the Existing System

It cannot be gainsaid that there are several defects in the working of the movement and the Committee on Co operation presided over by Sir Edward Maclagan in 1915 made an exhaustive enquiry into the working of the credit societies and pointed out defects and suggested remedies In many provinces their recommendations have been carried out, but there is still room for further action As the Royal Commission

---

[6] *Co operation in India*, by Wolf p 131

on Agriculture remarked, "Failures have frequently been due to the neglect of the wise precautions advocated by Sir Edward Maclagan and his colleagues, and we can only recommend that everyone connected with the movement should study this most valuable Report afresh and should strive to secure a wider attainment of the standards therein prescribed" (Page 448 of the Report)

The progress of the movement has not been uniform in all provinces and increase in numbers has not always meant improvement in quality In C P a thoroughly unsound system developed with a top-heavy organization Too much power was left in the hands of the central banks and very little was done to improve the education of the members in co-operative principles "The concentration of both authority and of fluid reserves at the centre provided opportunities for errors which precipitated a severe financial crisis, and it was only the assistance provided by the local Government, in the form of a large loan and a guarantee of a substantial cash credit, which saved the movement from immediate collapse

In the United Provinces the Oakden Committee in 1925 pointed out that the village society was mostly a sham, the staff was insufficiently trained and consequently unfit to carry on the task entrusted to it and there was little knowledge of the principles of co-operation In Madras a Committee was appointed which pointed out certain defects and to understand the whole position well, every province should get the case investigated by a committee The Royal Commission on Agriculture remarked, "The financial position of the movement is generally beyond dispute, it is the working of the society that is defective The members of the societies delay the repayment of loans even when able to repay, understanding of the principles of co-operation and knowledge of the essentials of rural credit are lacking, office holders refrain from taking action against defaulters and the spirit of self-help is not as prominent as it should be"

The causes of these disquieting features are

(1) *Lack of training and of understanding of co-operative principles is prominent*—Members do not take sufficient interest in the working of their society and there is little restraint over the executive committees

(2) *Accumulation of overdues*—Stringent action is not taken against defaulters and recovery of overdue debts by legal process is very slow The various provincial banking committees have laid special stress on this question and the Indian Banking Committee 'strongly emphasize the need for carefully scrutinising the economic purpose of the loan and

the repaying capacity of the borrower, in dispensing co operative loans "[7]

(3) *Defective Audit*—It is responsible for bad management and embezzlements "Audit, supervision and inspection of societies which are closely allied functions are now vested in two and sometimes three different agencies, resulting in much overlapping of work and waste of effort and money After a full consideration of these points, and of the efficiency of auditing system in European countries like Germany and Austria, we recommend that for the due discharge of the statutory functions of audit special district unions should be formed to carry out audit, supervision and inspection of the societies "

(4) *Inelasticity, dilatoriness and inadequacy of co-operative finance*—The loans granted to members are inadequate and great delay occurs in giving them In the U P the whole amount is given to the borrower at one time with the result that it is wasted and he has recourse to the money-lender The remedy is the introduction of a normal credit system in the societies The credit limit of each member should be fixed in advance and the necessary finance should be granted in time so that delay may be avoided by sanctioning applications for loans in advance It is the duty of the supervising and inspecting authorities to see that these credits are fixed by the societies in time and that the banks sanction them in due course This practice is gaining currency in Bombay and Madras Granting credits on current account and cheque transactions should be introduced wherever possible

(5) *High rates of Interest*—Agricultural credit in India is very costly as the following statement[8] shows —

Provinces	Rates charged to cultivators by primary societies Per cent	Rates paid to Central Banks on loans Per cent
Ajmer-Merwara	9 to 12	6 to 9
Assam	$15\frac{5}{8}$ to $18\frac{3}{4}$	11
Bengal	$7\frac{1}{2}$ to $15\frac{5}{8}$	$9\frac{3}{8}$ to $12\frac{1}{2}$
Bihar & Orissa	$12\frac{1}{2}$ to $15\frac{5}{8}$	$10\frac{1}{2}$ to $12\frac{1}{2}$
Bombay	$9\frac{3}{8}$ to $12\frac{1}{2}$	6 to 8
Burma	15	10
C P	12	9 to 10
Delhi		8 to 9
Madras	$9\frac{3}{8}$ to $10\frac{15}{16}$	$7\frac{1}{2}$ to 8
N W F P		8
Punjab	$9\frac{3}{8}$ to $12\frac{1}{2}$	8 to 9
United Provinces	15	12

7 *Central Banking Committee's Report*, p 153
8 *Ibid*, p 129

To a certain extent high rates of interest are inevitable because of the intervention of two or three intermediate agencies which are now found indispensable in every province The following suggestions can be made to reduce the rates of interest —

(*a*) Punctual repayment of loans by the members of the society and effective reduction of overdues

(*b*) Central banks should borrow money at cheaper rates for short periods to utilize urban slack money

(*c*) There should be a reduction in the working expenses of central banks where they are unduly high at present

(*d*) More intimate relations should be established between the provincial banks and the central banks so that the latter may follow the lead of the former in the matter of the regulation of their deposits

(*e*) Rural societies should directly tap savings wherever possible

In the U P additional defects are

(1) Accounts not accurately kept

(2) The inclusion of zemindars and money-lenders in the societies is disturbing the feeling of equality of status

(3) Absence of a provincial co-operative bank

Special steps should be taken for providing adequate and efficient training and for this purpose trained secretaries for societies should be obtained School masters and retired Government officials residing in villages can be of immense service in this direction With a view to avoid the evils of bad management in the societies, the members of their *punchayats* should be held personally liable for loans granted in excess of the limits prescribed by the by-laws of the society Nepotism should be avoided and better inspection and better supervision will go a long way in this direction

The Agricultural Commission wrote, "But we cannot regard as satisfactory the present arrangement under which the Registrar of Co-operative Societies in the Central Provinces is also Director of Industries and Registrar of Joint-Stock Companies" (Page 445 of the Report) It is a pity that the Government of the United Provinces should have gone under the pretext of economy contrary to the wise warning uttered by the Commission of experts in combining the posts

of the Registrar of Co operative Societies and the Director of Industries into one

Public funds should be spent in helping institutions whose object is to spread education in the application of co-operative principles to various objects Government aid is usually given for propaganda work and taking into view the illiteracy of the people and the consequent difficulty in reaching them by paper or pamphlet the Government should have a special interest in promoting organizations on a co operative basis to facilitate the activities of the various government departments

Other phases of the movement besides credit have not adequately developed in India and it is necessary that attempts should be made thereat Village welfare and reconstruction societies should be started without which village prosperity cannot develop In the U P village welfare work is a recent development of the activities of the societies According to the last annual report there are now 391 societies with a membership of 10,000 doing village welfare work There are societies for better living, promoting thrift, adult education, better farming, consolidation of holdings, etc Attention should be paid to this aspect of the co-operative movement

The following tables[2] show —

POSITION OF THE PRIMARY SOCIETIES

Year	No of Bank	No of Members		Loans made to members
		Individuals	Societies	Rs
1929 30	10	1 627	18 368	7,63,21 078
1930 31	10	1 636	18 630	7,59,13 472

Year	Loans and Deposits from Members etc			Working Capital
	Central Banks	Village Societies	Individuals	
	Rs	Rs	Rs	Rs
1929 30	6 32 79 221	7 05 11 801	29 99 87,499	8,62,00,508
1930 31	5 60 03 272	7,22 75,125	19 33 38,612	8 97 61,366

POSITION OF CENTRAL BANKS

Year	No of Banks	No of Members		Loan made to Members	Loans and Deposits	Working Capital
		Individual	Societies	Rs	Rs	Rs
1929-30	588	89 956	90 691	17,89 20 027	36 13 28 179	30 90 52 374
1930-31	597	91 109	1 01 399	12 69 94 691	34 72 02 811	30,67 10,319

[2] These four tables have been prepared from the *Statistical Statements relating to Co operative Societies* for the year 1930-31

Position of Agricultural Societies of all Kinds

Year	No	No of Members	Loans granted	Loans and Deposits received	Working Capital
			Rs	Rs	Rs
1929-30	91,786	31,17,627	15,07,17,677	24,86,06,312	34,93,12,049
1930-31	93,512	31,62,359	8,70,53,889	25,03,00,248	35 93,53,100

Position of Non-Agricultural Societies

Year	No	No of Members	Loans granted	Loans and Deposits received	Working Capital
1929-30	10,255	10 59 048	11,34,92,966	9,63,16,527	15,06,44,304
1930-31	10 528	11,41,592	11,86 05,097	10,54 21 222	16,32,99,584

Relations with the Imperial Bank of India and other Joint-Stock Banks

The various provincial banks and central banks have cash credit and overdraft arrangements with the Imperial Bank of India The following table shows the total amount of advances to co-operative banks by the Imperial Bank of India as on the 31st December, 1928[10] —

Province	Total Loans obtained
	Rs
Bengal	35,44,525
Bombay	12 31,750
Bihar & Orissa	8 85,000
Burma	30,72,410
Central Provinces	8,00,000
Delhi	7,89,612
Madras	75,87 900
Punjab	87,08,043
United Provinces	20,600

Laterly the Imperial Bank of India is reported to have changed its policy in respect of granting financial assistance to provincial and central co-operative banks and it is less ready to help them now than in the past It can continue giving accommodation against societies' pro-notes so long as this accommodation is required for short-term agricultural purposes If this accommodation is required for the purpose of fluid resources the Imperial Bank insists that Government promissory notes should take the place of the societies' pro-notes The idea is that co-operative banks may build up fluid resources within the movement itself and may not depend on the Imperial Bank in a time of crisis There are two objections to the present system Firstly, the value of the security depends upon the sound working of the co-operative

---

[10] Taken from *Indian Banking Committee's Report*, p 142, para 180

societies, which are not doing well and secondly, the pro notes of the societies are not a first class security, because the ultimate backing to them will be the sales by the Imperial Bank of the land of cultivators which will not always be a practical proposition The co operators contest this view and point out that the paper of only good societies is given to the Bank and further the security has the backing of the unlimited liability of the members and that the final recourse to sales of land to liquidate the paper is not likely to arise They further urge that maintenance of fluid resources means cost which means a reduction in their profit and consequential high rates of interest to agriculturists The Bank enjoys the benefit of the large free balances of the Government and it has a moral obligation to help the co operative movement In this connection the Indian Central Banking Committee remark, "We desire again to emphasize the importance of these facilities to the co-operative movement We feel that the change of policy to which we have referred is unfortunate, specially at a time when the co operative movement is growing in vitality and is extending the scope of its usefulness towards the social and economic uplift of the rural population and when its financial needs are therefore, likely to increase rapidly" (Paragraph 181)

Another complaint against the Imperial Bank by the co operative societies is that free remittance facilities are not always granted by the former to the latter and the co-operative banks have to certify that the transfer of funds is for co-operative purposes This action is defended on the ground that the societies being exempt from income-tax, it is irregular for them to compete with commercial banks in ordinary banking business when the latter have no such advantages In this connection the foreign banking experts remark, "The co operative movement in spite of imperfections and of unavoidable setbacks deserves every possible assistance from all quarters, because there is no better instrument for raising the level of the agriculturist of this country than the co operative effort, and a strong appeal to the banking interests of the country to assist the movement seems not at all out of place The Imperial Bank particularly ought to continue and to increase its endeavours to supplement the present organization of co-operative credit with expert advice in a business spirit and with financial assistance It may be a source of profitable business for the Imperial Bank"[11] The Indian Banking Committee remark, "We consider that free remittance of funds for co operative purposes is of the utmost importance

[11] *Memorandum of the Foreign Banking Experts*, p 628 of the Indian Banking Committee, para 2

to the co-operative movement and that no attempt should be made to curtail the privileges under the rules of the Government of India in this matter" (Page 145 of the Report)

The co-operative banks do not compete to a very great extent with the joint-stock banks because their respective spheres of activity are far apart "There is, however, a feeling that in the matter of deposits the co-operative banks with the help of Government assistance and prestige are competing unfairly But figures furnished by various Provincial Banking Committees tend to show that the allegation of unfair competition is not well founded Moreover, at present, the amount of deposits which the central banks accept are limited and the rates of interest offered for them are not likely to be higher than the lending rate of the provincial banks which is mostly 6 per cent for no purpose will be served by attracting dearer local money when cheaper money can be had from the provincial banks Generally speaking, it is, therefore, doubtful if there could be any serious competition between them and the joint-stock banks" (Paragraph 185)

Co-operative societies seriously compete with the indigenous bankers and money-lenders, but this has not embittered their relation as many indigenous bankers are directors of co-operative banks and the bigger bankers keep money on fixed deposit with co-operative banks

Some Demands of Co-operative Banks

(1) The co-operative banks want that the Imperial Bank should provide finance at cheaper rates and for longer periods than at present

(2) They want cash credits for agricultural operations to be granted by the Imperial Bank

(3) Where the Imperial Bank has no branches, approved central banks should be recognized as agencies for the management of Government sub-treasuries

(4) Inland exchange business should be recognized as a legitimate part of the business of the co-operative banks

(5) Cheap capital should be provided for the construction of godowns in rural areas to facilitate the marketing of agricultural produce

(6) Co-operative societies should be exempted from income-tax on their earnings from investments in public securities or land mortgage debentures

These demands seem to be reasonable, but under the present state of their working the societies cannot undertake the task of managing the sub-treasuries of the Government and they should direct their energies to strengthen their

position regarding the objects that at present fall within their province. With regard to the last point the Indian Banking Committee recommend that co-operative societies should be exempted from income-tax and super tax on their earnings from investments in public securities or land mortgage banks to the extent that such earnings are necessary for the purpose of their fluid resources and for the investment of their reserve funds.

Capital reserve, deposits and loans received, loans outstanding and cash balances of principal Indian co-operative banks for various years[1]—

BANKS WITH CAPITAL AND RESERVE OF RS 5 LAKHS OR OVER

Figures in 1,000 Rupees

Year	No of banks	Paid up capital	Reserve and other funds	Total	Deposits and loans received	Loans outstanding	Cash balances
1921–22	5	29,80	9,96	39 76	2,82,68	2 59 30	22 89
1922–23	5	30 68	12 92	43 60	3 41 05	2 57,48	47,71
1923–24	8	44 36	17,99	62,35	4,13,99	3 32,89	37 13
1924–25	8	47,53	21,73	69,26	4,51,11	3 53,81	19 08
1925–26	10	60,37	30 25	90,62	5 37,83	4 46 18	26 55
1926–27	12	76,95	35,59	1 12,54	7 00 65	5 18,13	13,29
1927–28	16	1,03 46	46,36	1 49 82	8 83,56	6,62,29	68,31
1928–29	18	1 16 99	46,35	1 63 34	9 01,49	6,80,29	77,76
1929–30	22	1 39 76	64 91	2,04,70	10 90 16	8 92,66	84,66
1930–31	26	1,55 72	88 75	2,44 47	12 35,52	10,33 38	85,81

BANKS WITH CAPITAL AND RESERVE BETWEEN 1 LAKH AND LESS THAN RS 5 LAKHS

Year	No of banks	Paid up capital	Reserve and other funds	Total	Deposits and loans received	Loans outstanding	Cash balances
1921–22	46	77 29	16,75	99 04	3 63,00	3,78,38	16 24
1922–23	63	1,01 63	29,42	1 31,05	5,02,02	5,18,84	15,03
1923–24	72	1,17 11	55,52	1 72,63	5,87,52	6 44 93	25,41
1924–25	93	1,20,93	49,30	1,70 23	8 03 76	7,72,43	40 51
1925–26	104	1,46,43	56,41	2 02 84	9,29,81	8,79 51	62 52
1926–27	119	1,53,49	71,25	2,24,74	11,97 69	11,27,53	73,14
1927–28	126	1,61 56	86,94	2,48,50	13,17,41	11 99,67	79,89
1928–29	141	1,79,89	98,32	2,78,21	14,99,42	13,20,30	72,20
1929–30	157	1 95,78	1,12,27	3,08,05	16,12,78	14,12,10	67,67
1930–31	170	2,07,82	1,28,49	3,36,31	17,74,59	14,03,32	66,77

[1] This and the following table have been taken from the *Statistical Statements relating to Banks in India for* 1930, p 7

CHAPTER VII

Land Mortgage Banks

Co-operative credit societies can supply only short-term credit to agriculturists for financing current agricultural operations They cannot afford to lock up their short-term deposits in long-term finance Cultivators require money for redeeming their mortgaged lands and houses and also for introducing permanent improvements in land and for clearing off their past debts These operations require large amounts of money which can be repaid by the borrowers in long periods Co-operative societies are unable to finance these long-term needs of the cultivators Hence arises the need for special types of institutions called the Land Mortgage Banks

These special institutions differ widely in their operations from country to country In Prussia and the U S A the general form of these institutions is of a co-operative type The Prussian Farm Mortgage Mutual Credit Associations are associations of borrowers having no capital They do not aim at profit and keep interest rates at low levels Credit is created by the issue of land mortgage bonds The Federal Farm Loan Banks of the United States of America are also of this type The other type is the commercial type found on the continent of Europe These banks pay dividends and are of an ordinary joint-stock type The state exercises some control over them with a view to safeguard the interests of the borrowers The Agricultural Bank of Egypt and the French Model of Credit Foncier De France represent this type In between them, there are institutions which may be called of a quasi-co-operative character, because they combine co-operative and commercial ideals in varying proportions Their members are borrowers as well as non-borrowers Each member has one vote irrespective of the number of shares held and the dividend on share capital is fixed at a low amount The Hungarian Land Mortgage Institute for large land-owners and the National Small Holdings Land Mortgage Institutes for small land-owners are examples of this type

Position in India

There are some land mortgage banks working under the Co-operative Societies Acts in the Punjab, Madras, Bombay, Assam and Bengal The provinces of Bihar and Orissa, Burma, C P, Berar, the U P, and the Central Areas have no such banks Strictly speaking, these banks in India are of a quasi-co operative type They are limited liability associations of borrowers

with a few non-borrowers as members and the object of admitting the latter to membership has been to attract capital, business talent and organizing ability so very necessary for efficient management The number of shares owned by members is limited and generally a shareholder has one vote irrespective of the number of shares held by him Dividends are restricted to a low amount and the object is to eliminate non borrowers gradually The work of a mortgage bank 'is recognized on all hands to be extremely impersonal and as devoid of human element as possible' and the human and personal elements of the Raiffeisen type cannot be inculcated into them with success In the unlimited liability society, mutual knowledge of and control over one another are insisted upon to a great extent but in a land mortgage credit society, emphasis is laid upon the capacity and business habits of directors to ensure success

In the Punjab there are about 12 land mortgage banks, the first having been started in 1920 Loans are made for the redemption of land for the liquidation of unsecured debts and for improving land and up to 1930 about Rs 2 lakhs were advanced on these various objects Overdues are frequent and directors are reported to be too indulgent in the matter of loans to themselves and to their relatives with the result that laxity and frauds are prevalent In Madras two banks were registered in 1925 and by 1927 there were ten banks each operating over a distance of five mile radius with a view to facilitate land valuation They raised money by debentures and the Government agreed to purchase at 6½ per cent interest debentures subject to a limit of Rs 50 lakhs for any one bank and Rs 2½ lakhs for the whole province provided an equal amount was obtained by selling them to the public They limited the loans to individuals at Rs 2,000 A Central Land Mortgage Bank has also been started to finance local mortgage banks The Provincial Co-operative Bank purchased its debentures to the extent of Rs 1 lakh and the Government lent Rs 15 000 without interest for a few years and guaranteed 6 per cent interest on debentures, up to a maximum of Rs 50 lakhs, floated in the first five years In Bombay Bengal and Assam also the main characteristics are the same The period of loans in Bengal varies from 1 to 20 years, in Bombay from 10 to 30 years and in Assam up to 20 years The Bombay Government have agreed to purchase the debentures of the banks to the extent of Rs 5 lakhs

Recommendations of Provincial Banking Committees

The Assam Committee suggest that loans should be confined for the present to the purpose of the repayment of old debts and they do not recommend the issue of debentures in the initial stages but rely on deposits in the matter of raising

the necessary finance The Bengal Committee have suggested that co operative central banks should open land mortgage departments They have recommended that the period of loans should extend from 5 to 20 years and the amount advanced to members should not exceed 50 per cent of the value of the mortgaged property The issue of debentures has been recommended, and it has also been suggested that the Government should guarantee interest on them and that debentures should be included in the list of trustee securities The Bombay Committee have stressed the need of the establishment of a central land mortgage bank whose membership should be open to the Indian joint-stock banks, the Imperial Bank of India, the co-operative banks and land holding classes The issue of debentures with Government guarantee with regard to interest and principal has been recommended and it has been suggested that the central land mortgage bank should absorb the existing long-term taqavi operations of Government Debentures should rank as trustee securities in case of Government guarantee The Madras Committee are of opinion that the central land mortgage bank should not ordinarily receive short term deposits and that the debentures should be trustee securities The new primary banks at the outset are to be limited to more fertile areas The central land mortgage banks should work in collaboration with the rural credit societies The Punjab Committee recommend the reduction of the existing limits to Rs 5,000 and they suggest that loans to directors should be restricted The period of loans in the beginning should not exceed 10 years although later on it might be increased to 15 years Debentures of co-operative land mortgage banks have been recommended to be included in the list of trustee securities

A Historical Retrospect

The constitution of land mortgage banks in India has been under discussion for a long time, and it is unnecessary to refer to the discussion that took place prior to the Registrars' Conference in 1926 The Conference recommended the establishment of banks on co-operative principles and that the transactions undertaken were to be economical to the borrowers Loans were recommended to be given for the redemption of the land and houses of the agriculturists, for improving land and methods of cultivation, for the construction of houses, for the liquidation of old debts and, in special cases, for the purchase of land The area of operations was recommended to be the smallest unit consistent with good management It was also suggested that debentures should be issued by a central financing agency in each province rather than by mortgage banks

The Royal Commission on Agriculture also considered the question and generally endorsed the resolution of the Registrars' Conference of 1926 It was pointed out that the guarantee of interest on debentures was the most suitable form of state help to these banks and, therefore, Government help in the form of subscription to debentures was ruled out Debentures bearing the Government guarantee of interest were recommended to be added to the list of trustee securities The issue of debentures was recommended to be controlled by a central organization It was also suggested that for some years to come an official member should be associated with the board of management of each bank

The Registrars' Conference of 1928 discussed these proposals and their conclusions do not materially differ from those of the Registrars' Conference of 1926 and of the Agricultural Commission The only difference was that while recognizing that the guarantee of interest on debentures of the mortgage banks by the Government was the most suitable form of help, the Conference nonetheless recommended that in the early stages, the Government should subscribe to the debentures of the land mortgage banks and should also give assistance in the form of loans to them

Recommendations of the Indian Banking Committee

The Indian Banking Committee have recommended the establishment of the co-operative type of land mortgage banks to meet the long-term needs of the small holders and the commercial type to meet the needs of the big landholders in India As regards co operative central banks, they have laid down that no money should be advanced to the borrower which is not economically profitable to him Keeping this principle in view, loans should be granted for the redemption of the land and houses of agriculturists, for the liquidation of old debts, for the improvement of land and methods of cultivation and the building of their houses, and for the purchase of land in special cases

The amount and the period of the loans should be fixed with reference to the repaying capacity of the borrower and it should also depend upon the purpose for which money is advanced The period of loans is recommended to vary from 5 to 20 years in the beginning which, if necessary, can later on be increased to 30 years The maximum to be lent to an individual should not exceed Rs 5,000 and the amount of the loan should not be more than 50 per cent of the value of the mortgaged land Repayment has been recommended to be according to a system of equated payments on which basis the loan would be amortised at the end of a certain period of time "We are, therefore, of the opinion that if local conditions

require, a system of graduated payments may be adopted so as to provide for repayment by larger instalments commencing after the investment of the loan on the land has resulted in increased profit In any case we consider that it is useful to provide alternative methods of repayment in the by-laws of the bank with full power to the management to enforce that method of repayment which it considers suitable" (Paragraph 220 *Central Banking Committee Report*)

Capital should be raised in three ways, *i e*, through shares, debentures and deposits Shares may be initially sold to prospective borrowers which will provide security for debentures The second method is to deduct a certain percentage of loan, say 5 per cent at the time of advancing the loans This method prevails in America and in the Indian provinces in Madras only Debentures should not exceed five times the share capital Government guarantee for the repayment of the principal is not recommended and the guarantee of interest for the whole period of their currency is regarded as the best one They have been recommended to be included in the list of trustee securities if the Government guarantees interest on them In case of necessity, the Government may also purchase debentures of the bank For providing initial resources the Government should advance loans free of interest in case of necessity to be repaid out of the proceeds of the debenture issue The debentures should be issued by a provincial land mortgage corporation and the actual sale of debentures can also be made by primary land mortgage banks The provincial land mortgage corporation should be separate from the provincial co-operative banks

SUMMARY POWERS OF RECOVERY

Loans can be made to members on the recommendations of primary credit co operative societies, but the ultimate responsibility for ascertaining the financial position of the applicant should rest with the management of the mortgage banks To encourage the habit of thrift long-term deposits for not less than five years should be accepted A provident fund scheme is also recommended according to which the borrower can contribute annually a fixed sum to the fund on the basis of his ordinary surplus in a normal year The banks may also issue savings certificates payable after 3, 10 or 15 years

The banks should have summary powers of recovery by foreclosure and sale without the expensive intervention of civil courts There will be one disadvantage of vesting summary powers in the banks whose management might become lax in scrutinizing the security offered for loans and there may be carelessness in fixing the amount of the loan "At the same

time we recognize that the right of the aggrieved party to question in *the civil courts the action of* the bank should be fully safeguarded. . . . . We, therefore, definitely recommend that the power of foreclosure and sale by the land mortgage banks without recourse to civil courts should be given to the land mortgage banks subject to the above safeguards." (Paragraph 225, *Central Banking Committee Report.*) Greater protection should be given to land mortgage banks against avoidance of mortgage by the unsecured creditors of the insolvent.

LAND ALIENATION

The operation of the Land Alienation Acts in various provinces in India makes it impossible for the lender to secure the free sale of land in case of default of the mortgager. Land mortgage banks can lend money for long terms on sound and freely saleable property. Land should be freely transferable without legal or customary hindrances. These Acts prevent the free transfer of land to non-agriculturist classes. They prevail in the Punjab, certain parts of the C. P., in Bundelkhand, in the U. P. and in the centrally administered areas. The Central Areas Committee say that the Act has adversely affected the credit of the agriculturist, though borrowing for wasteful purposes has been prevented. The agriculturist lender is replacing the non-agriculturist lender and the borrower requires protection against the latter. The Central Provinces Committee think that the credit of the borrowers has fallen as a result of the Act and that from amongst the Gonds to whom the Act applies a money-lending class has grown up. The Act perpetuates the backwardness of the Gonds. The Punjab Committee lay down that the non-agriculturist rural money lender is being replaced by the agriculturist money-lender who is a big landlord also. The latter is taking advantage of the Act at the expense of the peasantry. The U. P. Committee are of the same opinion and according to them the benefit of the Act is at best questionable from the point of view of the borrower whose credit has shrunk.

Steps should, therefore, be taken to remove all restrictions, legal or otherwise, on the free transfer of land. A special provision is necessary for protecting land mortgage banks where Land Alienation Acts are now in force. Before the bank can advance loans it must be sure of free transfer of the property of the mortgager in case of the latter's default. Further, "if there are restrictions on the alienability of the land for the recovery of dues in the case of one class of members, while the land of the other class of members can be freely sold for such recovery, the essential feature of co-operation, namely, equality of the status of members will be sacrificed. In view of these difficulties we recommend that an alteration

should be made in the Land Alienation Acts which would give to the co-operative land mortgage banks the right to take possession of land through foreclosure on default of the payment of the instalment of the loan and to sell it"

COMMERCIAL LAND MORTGAGE BANKS

The most outstanding example of a commercial land mortgage bank is the Credit Foncier De France It enjoys certain privileges and is supervised by the Government It advances loans up to 40,000 francs repayable in 25 years at low rates of interest It acts also as an apex bank for regional mortgage banks In Japan the Hypothec Bank (founded in 1895) has specialised in long term loans repayable in 50 years In England, the English Mortgage Credit Corporation was set up under the Agricultural Credit Act of 1928 The Ministry of Agriculture and Fisheries can advance loans up to £750,000 free of interest for 60 years for establishing a guarantee fund The Minister can contribute £10,000 towards the cost of the administration of the Corporation and the Treasury can procure the underwriting of the debentures up to a sum not exceeding £5,000,000 and can itself purchase one-fourth of the issue subject to a maximum limit The debenture stock is the trustee security The Agricultural Bank of Egypt which was established in 1902 advances loans to small farmers up to £200 without mortgage security and up to £1,000 for 20 years against a first mortgage The Government guaranteed interest at 3½ per cent on £4¾ million of bonds issued by the bank

In India there is a commercial agricultural bank in Burma known as the Dawson's Bank which operates in the Irrawadi delta The Burma Committee and the Bihar and Orissa Committee have recommended the establishment of joint-stock land mortgage banks for big land-owners The latter committee say that the bank should be established under Government control and that the Government should supply initial capital They have recommended the association of land revenue administration officials with the management of the bank The control of the Government is to be reduced to a minimum when borrowers gradually begin to purchase the shares of the bank

In this connection the Indian Banking Committee write "We recommend the development of well-organized joint-stock land mortgage banks in this country for the benefit of the numerous classes of land-owners who cannot be adequately served by the co-operative credit organizations We also commend for the consideration of local Governments whether they should not take the initiative for the establishment of such banks and assist in ensuring the success of their operations, providing for this purpose a portion of the initial capital

Such action would be on the lines of that recently taken in England If, in any province, the provincial Government undertakes to guarantee the interest on the debentures issued by the bank, such debentures should be included in the trustee securities We should like to lay down the principle that the loans should provide for a safe margin and the period and instalments of repayment should be fixed with reference to the repaying capacity of the borrower as judged from, among other things, the net income from the mortgaged land " (Paragraph 235, *Indian Banking Committee Report*) The need for such institutions is specially felt in the permanently settled provinces where land-owners obtain credit at onerous terms

Money-lender's Co-operation Necessary

Whatever the scheme of land mortgage banks may be, the rural money-lender should be roped into it if progress consistent with the requirements of cultivators is to be made There is an important criticism to which the scheme of the Central Banking Committee is open and that is that it does not make provision for enlisting the services of rural money-lenders on a large scale Any scheme which is rival to the money-lender has little chance of success He should be made a part and parcel of the land mortgage banks so that his local experience and funds may be freely available for the benefit of the banks and the rural classes He should be made to deposit, voluntarily and willingly, his funds with the land mortgage banks at terms which are attractive to him He should not be sought to be eliminated, but should be given a status in rural society so that he may be able to render services for the benefit of rural India

Mr Manu Subedar in his *Minority Report* has expounded a scheme according to which the Reserve Bank should open land mortgage departments which should grant loans to borrowers through guarantors The big Mahajans who make certain deposits with the land mortgage departments are to give a guarantee regarding the safe repayment of the loans by the borrowers A Government valuer is to value the land mortgaged by the mortgager and this transaction and value are to be approved by the guarantor ' The idea is that the bank lends out against the security of land This security is valued by a Government valuer and the value is checked or approved of by the guarantor The document would be between the bank and the borrower and would remain in the possession of the bank The arrangement between the bank and the party would have to be approved by the guarantor The guarantor would guarantee to the bank the repayment of the debt Whether he should be responsible for prompt and immediate payment of instalments not paid

by the borrower, or whether there should be elasticity about this, is a matter of detail. He (the guarantor) is responsible for the final recoveries which are covered by a solid security, but it is essential that his assistance should be available for effecting recoveries" (*Minority Report*, pages 68, 69.)

Disarming Mahajan's Opposition

A pertinent question is: Why should the guarantor undertake this risk? He will lose a source of his income and, therefore, he will throw his whole weight against the scheme. If anything could be done by which he could make a sure income on his money with considerably reduced risks and with an advancement in his status, it would attract him to join the scheme. He is, therefore, to make a deposit with the bank which cannot be withdrawn until the loan is repaid. He will get a reasonable rate of interest on this loan. He will then become the guarantor and recommend loans from the land mortgage debenture funds in some multiple of his deposit which may be fixed in the proportion of 1 : 5 to start with and later on it can be increased. On such loans the guarantor would also get some commission, say 1½ per cent. Suppose the bank gets deposits at 6 per cent and 1 per cent are the expenses to the bank, 1½ per cent will go to the guarantor, making it 8½ per cent in all. If he can recommend loans in the ratio of 1 : 5 in relation to his deposits, he will get 6 *plus* 7½ or 13½ per cent in all. "The risks, the expenses and the worry to the Mahajan in respect of these loans at least are considerably reduced and his energies are released for other activities." The advantage to the bank is that it gets the benefit of local knowledge and the selection of the borrower is left into the hands of a local shrewd party. This will disarm the opposition of the Mahajan and will ensure popularity for the scheme through the co-operation of all parties. "It would do genuine good to the borrower by enabling him to economise over interest charges. Economically there is everything to recommend in this programme. But from the psychological point of view, it will mean the first attempt to bring the Mahajan in a definite link with the central money market. It will mean recognizing his position in the district and strengthening his position so that he still remains the respected man amongst his fellows instead of being dislodged. For the cultivator, it means the hopefulness and prospect of removing the overload of debts relating to long periods. If it is the policy of the banks that foreclosures have to be avoided and the borrower's position should not be allowed to get worse, the Mahajan can help in this matter as he can also exert much moral pressure against the cultivator getting into serious debt outside. It will clear the atmosphere and it will put to the credit of the state a genuine measure for the

welfare of those agriculturists, who are outside the field of the co operative movement for any reason '

The above scheme of entrusting the functions of land mortgage banks to the Reserve Bank does not seem to be quite sound because the Bank's high officials would have many other things to do and will not be able to devote time to all and sundry matters Moreover the co operative and commercial land mortgage banking should be kept separate as there are advantages in doing so But whatever the actual details of the scheme may be, the co operation of the village Mahajan seems to be highly indispensable and any scheme which leaves him out must meet his bitterest opposition and consequently its success may be jeopardised

CHAPTER VIII

Industrial Finance

THERE is a general feeling in India that our industrial progress during the last fifty years is very meagre as compared with India's vast resources and the needs of her population In 1928-29 the total value of the imported articles, mainly manufactured, came to Rs 180 crores out of a total of Rs 253 crores of imports, whereas the total value of mainly or wholly manufactured articles exported from India amounted to about 90 crores out of the total exports of Rs 330 crores The value of raw materials exported amounted to Rs 170 crores and the value of raw materials imported amounted to Rs 23 crores only In view of these figures it must be said that the Industrial Commission truly depicted the position when it remarked, "India produces nearly all the raw materials necessary for the requirements of a modern community, but is unable to manufacture many of the articles and materials essential alike in times of peace and war" The Famine Commission of 1880 observed, 'At the root of much of the poverty of the people of India and the risks to which they are exposed in seasons of scarcity lies the unfortunate circumstance that agriculture forms almost the sole occupation of the mass of the population"

The policy of the Government of India up to the outbreak of the war was one of *laissez faire* and the first attempt at a general policy of industrial development was in the form of "a very imperfect provision of technical and industrial education, and the collection and dissemination of commercial and industrial information" 'This policy of non-intervention of government and their attitude towards the industrial development of the country combined with instances of anomalies in the fiscal, railways and stores purchase policies till recently followed in the country has exposed the government to the charge of open hostility towards the interests of Indian industries prompted by the over-riding considerations of advancing British interests'[1]

The Industrial Commission of 1916-18 made certain proposals which depended upon the acceptance of two principles Firstly, the Government must play an active part in the industrial development of the country, and secondly, the Government could do so only when it was equipped with adequate administrative machinery and got reliable scientific and technical advice According to the recommendations of the Commission,

---

[1] *Indian Banking Committee's Report*, para 325

the Government help was to include provision of research, industrial and technical education, commercial and industrial intelligence technical and financial help and the purchase of stores The Montagu-Chelmsford Report of 1917 also emphasized that the Government must admit and shoulder its responsibility for furthering the industrial development of the country In 1921 the Indian Fiscal Commission recommended a policy of 'discriminatory protection' and the creation of a Tariff Board As a result of the action taken on the recommendations of the Tariff Board, the industries which have benefited most are cotton textiles, iron and steel and match There is, however, still a considerable amount of feeling among the intelligentsia of India that the State, and particularly the Central Government, is not taking as much interest as it ought to in the development of India's industries[2] This is evidenced by the belated effect given to the recommendations of the Tariff Board in many cases and by the fact that there has been no revision of the Railway Rates so far on the lines of the Report of the Industrial Commission The latter had also recommended the appointment of an expert committee at the earliest possible date to examine the possibilities of the establishment of industrial banks in India and this committee was appointed 10 years after the recommendation made by the Industrial Commission

In marked contrast to the attitude of the State in India the Governments in foreign countries have helped industries to a great extent The following statement of Prof Taussig for American industries is noteworthy 'Rich natural resources, business skill improvements in transportation, widespread training in applied science, abundant and manageable labour supply—these, perhaps suffice to account for the phenomena But would these forces have turned in this direction so strongly and unerringly but for the shelter from foreign competition ?'

In Japan there has been very rapid industrialization since 1868 as a result of the active policy of the State The contribution of manufactured goods of the Japanese export trade rose from 1 14 per cent in 1868 to 42 52 per cent in 1928 and the imports of manufactured goods fell from 60 57 per cent in 1858 to 15 6 per cent in 1928 At the beginning of her industrial career, exports of raw materials were 26 27 per cent which fell to 4 17 per cent in 1928 and the imports of the same rose from 4 98 per cent to 53 12 per cent in 1928[3]

---

[2] *Indian Banking Committee's Report,* para 325

[3] The Japanese Government realized the seriousness of the situation and embarked on an active national policy Numerous students were sent abroad to study the industrial and commercial technique of the West, importation of foreign experts to train the Japanese

In England also till lately the home of *laissez faire*, the Government has come actively to the assistance of industries and between 1921 and March 1927 a loan of more than £ 79 million was raised under the Trade Facilities Acts for approved purposes on behalf of private concerns with Government guarantee [1]

Capital Requirements of Industries

Industries require capital for two purposes (1) Capital for block or to finance fixed assets Newly started industries require money for land, buildings, machinery and other appliances of a durable kind Old established industries also require long-term capital for extensions and replacements (2) Working capital is required to purchase and work up raw materials into finished goods, for stores, for expenses on marketing and advertisement and also for day-to-day requirements A portion of working capital is also of the nature of long-term finance There is a certain stock of raw materials and manufactured or semi manufactured goods which never falls below a certain minimum and money required to be spent upon these goods is also permanent capital Working capital required above this minimum is of the nature of short-term finance The relative proportion between working and block capital varies from industry to industry Where processes are 'round about', proportion of fixed to working capital is very large as in the cotton mill industry, iron and steel industries and the hydro-electric industry In industries where processes are not round about' and implements are comparatively inexpensive as in cottage industries, the proportion of fixed to working capital is very small

Existing Facilities in India

Industries in India are not able to obtain finance to an adequate extent The Imperial Bank is not allowed to grant loans on the security of shares and fixed assets and it is thus unable to grant loans to industrial companies for capital expenditure and even as regards working capital secured by

---

in industrial technique and other machinery for industrial training was also provided New industries such as textiles, iron and steel, ship building, etc, were started Capital was supplied whenever possible and substantial help was rendered by granting subsidies or giving protection Commercial museums were opened by the Government in almost all the cities to hold periodical exhibitions by which the sale of goods abroad was facilitated and useful information was supplied to the traders The Yokohama Specie Bank was established in 1880 and the Industrial Bank of Japan in 1902 which gave impetus to the progress of Japan's industrial development For details see Rau *Present Day Banking in India*, p 290, G C Allen, *Modern Japan and Its Problems*, 1928, p 166, and the *Indian Central Banking Committee's Report*, pp 265, 266

[1] See *Report of the Liberal Industrial Enquiry*

liquid assets, it insists on a margin of 30 per cent and it cannot grant loans for more than six months The industries have thus to provide not only the whole of the long-term capital, but also 30 per cent of the short term finance 'This attitude of the banks in India, added to the shyness of Indian capital, acts as a damper on the industrial development of India' Banks usually insist on a full backing of tangible and easily marketable security and do not grant loans on personal credit and integrity of the borrowers This is because banks do not have confidence in industrial concerns due to bad management of the latter, but it is to some extent the business of banks to distinguish between good and bad concerns and to help those concerns whose position is sound The insistence of the banks on a 30 per cent margin against stocks of goods is a great hardship to industries specially in times of low prices The Cotton Textile Industry is passing through very bad times and the Managing Agents, who in ordinary times can raise finance without difficulty, are unable to cope with the situation at present In other countries, banks would have nursed such important industries by a bold and generous policy Banks in India at present finance industries out of short-term deposits but the industries are not always sure that the loans would be renewed on expiry of the period In the Bombay Presidency and specially in Ahmedabad, industries get capital through public deposits and these deposits are withdrawn in bad times from good as well as from bad concerns and industries cannot always depend upon them Further, rates of interest for loans and advances are very high, the usual rate being the Imperial Bank Rate or one or two per cent higher The Imperial Bank Rate fluctuates owing to seasonal stringencies which means a real hardship to industries

Capital for industrial development from the public is not easily forthcoming and debentures are not as popular in India as elsewhere This shyness of Indian capital is due to a variety of causes (1) There is no recognized method in India by which people can obtain advice, guidance and assistance with regard to industrial investments Bankers' clients can obtain this type of help from their banks in other countries but there are no banks in many urban centres of the right type which can guide their customers in such matters in India (2) The failure of many smaller concerns has shaken the confidence of the public in industrial investments and people prefer postal savings banks and other Government securities to industrial investments (3) Some investors look to capital appreciation

[5] This is in striking contrast to the position in England where for current business purposes banks grant loans on the personal security of the borrowers See Walter Leaf's *Book on Banking* quoted by the Indian Banking Committee

and fixed interest bearing debentures with no prospect of capital appreciation do not appeal to them (4) Insurance companies in other countries invest a large portion of their funds in the securities of first class concerns, but in India there is no insurance company which has taken to this kind of investment (5) Heavy stamp duties on debentures and transfers of debentures are additional impediments in the way of the popularity of industrial debentures (6) The fiscal policy of the Government which does not guarantee protection against foreign competition is another reason for the shyness of Indian capital 'We have heard the complaint that though machinery has been set up by the Government to consider the claims made by various industries for protection namely, the Tariff Board, the recommendations of this Board are not always carried out by the Government It is therefore, argued that the investor in an industrial undertaking has no assurance that the industry in which he invests will reach the profit-earning stage or that the profits, when once they accrue, will be maintained by inauguration of proper protective measures on the part of the Government of the country '

Industrial Banking in Other Countries

Germany—In Germany an industrial firm has a current account with its bank and at times it is in debt to the bank and at other times it has a credit balance with the bank The amount of indebtedness, the period for which the loan is to be outstanding and the security to be offered are matters settled between the bank and the borrower beforehand The current account balances are used by firms in Germany not only for short-term finance for working capital, but also for block capital for extensions in anticipation of recourse to the investment market

Initial capital is provided in two ways The promoters offer capital to the public or they themselves take over the entire capital in the beginning with the intention of offering it to the public later on Lately, the second method has supplanted the first to a great extent, and in this connection the German banks have played a great part in providing the initial capital which is released to the public subsequently or sold directly to customers having relations with the banks A number of banks join together to share the risk It may be noticed that the investment of German Banks in shares of industrial companies is not a long term investment and is resorted to merely as a safe and liquid investment for part of the banks' resources in first class securities The banks in this way acquire business connections and influence The German banks thus play an important part in financing enterprises The ordinary banking business is, of course, the most important with German banks, but in addition, there is a

department for industrial and similar finance, 'with a limited share of the banks' own resources, for carrying on financial transactions arising from time to time in the relations of the bank with the industrial and similar joint-stock companies' These transactions require a certain amount of capital investment which is in close relationship to the capital and reserves of the banks Though in the aggregate it remains stable, its composition quickly changes according to market conditions and if the public does not respond to the offer of securities resulting from such industrial finance, the banks cannot continue assisting industries till such time as the public is again prepared to put up the new capital [6]

---

[6] Mr N R Sirkar writes that this account of the German banks is not only inadequate, but that the lesson of the German banks is not rightly appreciated by the Indian Banking Committee The German banks play a large part in the provision of long term capital. They attend an industrial undertaking from birth to its death and help the concern through thick and thin They have satisfied the need for an institution to educate and encourage the general public in investing their surplus funds in industries There was a place for some kind of agency which should obtain the confidence of the investing class, and use their confidence to direct their capital towards sound industrial undertakings It was primarily the filling of this place that called into being the Credit Banks of Germany and accordingly these banks gave a prominent place in their programme to the development of Joint Stock Companies The German investors are even now reluctant to participate in any undertaking before it is fully launched and they have a peculiar preference for projects in which a leading bank has interested itself' See his *Minute of Dissent* on p 538 of the *Indian Banking Committee Report* In this connection the foreign banking experts are of a different opinion According to them, the starting of industries is nowhere considered to be a bank's affair An industrial company has to find its block as well as its working capital and it must prove itself strong enough before it is fit for industrial finance They remark, '*Under* the German Banking system such financial transactions which occur from time to time are, however limited from the same conditions which govern the English Issuing Houses They require a responsive capital market and if the public are willing to put up the new capital required by the industrial company and which is offered to the market in a suitable shape, then the banks under the German system will not take the place of the public They will not themselves furnish to the industrial company what the investing public is not prepared to take If the public is not responsive to the offer of the securities resulting from such industrial financing, then the amount normally invested by the banks cannot be raised The German system offers indeed a great many advantages for the industrial development of a country and benefits the banks as well This, however, is only on the condition that the business of the finance is handled with the utmost caution and care Banks engaging in industrial finance should not and indeed do not start any new industries, nor should they manage industrial enterprises by themselves German banks do not employ a staff of industrial experts What they do is to cultivate not only regular commercial banking business but also financial transactions They develop a sympathetic attitude for the needs of industry" See Annexure II by Foreign Experts submitted to the Indian Banking Committee

Belgium.—The banks in Belgium have rendered great services to her industries and they were the only source from which industries could get financial help. The Societe Generale de Belgique, established in 1822, was the first joint-stock bank in Europe to develop industrial banking and it also controlled various industrial concerns.

France.—In France, special institutions called Banques D'Affairs have grown up to finance industries. They participate in the capital of industrial concerns and help in placing their bonds and shares with the public.

Switzerland.—The connection between banking and industries is very close in this country. The Trust Banks there issue their own bonds whose proceeds are utilized for granting long-term loans to industries and for purchasing their shares.

Italy.—The establishment of the Societa Financiaria Italiana which took over the industrial securities held by the Credito-Italiano paved the way for a sound system of long-term finance.

Ireland.—In 1926 the Industrial Trust Company was established in Ireland with direct Government assistance with a view to facilitate the financing of those enterprises which had previously got loans in the form of Government guarantees under the Trade Loans Acts which were due to expire then.

England.—In England a very cautious policy is followed by clearly separating industrial from commercial banking. There are various international Issuing Houses in England which take up the matter of industrial finance and keep themselves directly in touch with the concerns they finance. With their help, the securities of industrial concerns can be easily put on the market. Owing to the development of the Investment Market in England, the Issuing Houses can readily invest money in the capital of industrial concerns to release the shares to the public.

Japan.—Japan was not slow in putting into practice the principles and methods of Western countries and the Industrial Bank of Japan was established in 1902 to finance Government loans and to make advances against Government and Semi-Government securities, against ships, ship-building materials and other industrial issues. With the approval of the Minister-in-Charge it could purchase or under-write stocks and shares. The Government exercises control through the Minister-in-Charge who appoints the controller for supervising the Bank's business. Dividends to the shareholders can be declared on the approval of the Minister. In the beginning the Government guaranteed a 5 per cent dividend up to 5 years. The Government supplies funds to the Bank at a moderate rate and guarantees capital redemption and interest payment.

of the Industrial Bank of Japan loan bonds if such loans are floated in foreign countries

A study of these facts shows that private enterprise and initiative alone cannot be depended upon to provide the necessary financial help for industries, and some special type of institution is very necessary to provide long-term finance and to infuse confidence into the public so that the latter may invest their money in industrial investment securities This special institution should be, as a general rule, apart from the commercial banks Granted that a special type of banks is necessary for industrial finance, the question is whether it should be a provincial industrial corporation for every province or a Central Institution

The arguments in favour of a Central Institution are —(1) In the present state of depression, the Central Government will be in a better position to raise finance for purchasing the capital of the corporation or for giving a guarantee regarding the return on capital than the Provincial Governments (2) The directors of the All-India Bank being men of All-India reputation will command greater confidence of the public than the directors of provincial banks because of their wider knowledge and outlook and hence the Central Institution will find it easier than separate provincial institutions to raise money for shares and debentures (3) An All-India Bank with greater resources and well-distributed investments in industries will be better able to tide over periods of depression (4) An All-India Bank will guide the industrial development of the country on very sound lines as it will gather knowledge and experience from all parts of India and will have a well equipped intelligence department (5) A Central Institution will be able to employ a staff of experts in various branches very economically to advise on industrial propositions throughout the country

The arguments for a Provincial Institution are (1) The Provincial Governments will find it easier to supply a small portion of their financial assistance than will be the case for the Central Government on whom the total demand will be very heavy (2) 'Industries' being a transferred subject the Provincial Governments should be allowed to deal with it as they think best (3) The advantages of a centralized issue of capital are real within some limit and the competition of the Central Government for capital in the All-India markets has also to be considered (4) Provincial Banks will be better able to look to the needs of their provinces than an All-India Bank specially as cottage industries will also have to be financed by the banks (5) The economy of engaging technical experts at the centre is not very important as there will be few occasions on which their services will be utilized

Details of Schemes placed before the Indian Banking Committee

(*a*) *Capital*—It was proposed that the capital of the Industrial Bank should be raised partly by shares and partly by debentures and different estimates were given for the capital of the All-India Bank One suggestion was for Rs 50 lakhs to start with which could be increased according to requirements, another suggestion was for Rs 3 crores on the basis of Rs 30 lakhs for each province which could be supplemented later Another suggestion was for Rs 10 crores of authorized capital of which Rs 2 crores might be raised initially In the case of a Provincial Bank for Bombay a suggestion was made for an authorized capital of Rs 5 crores and paid-up capital of Rs 1 crore according to the industrial possibilities of the province

(*b*) *Receipt of Deposits*—Various suggestions were made for the receipt of deposits Some witnesses suggested long-term deposits for not less than 3 years so that competition with indigenous banks might be avoided It was also pointed out by some that the bank should receive short-term deposits and in the early years should do commercial banking business because people would not be prepared to place their deposits with the bank for long periods, but those in favour of long-term deposits favoured Government guarantee to inspire confidence among the depositors In this connection the Industrial Commission had recommended to this effect, "It appears to follow that an industrial bank with a sufficiently large capital to ensure its safe working must combine ordinary banking business with its industrial activities to enable it to obtain a return on its capital But the clearest possible distinction must be drawn between industrial finance and ordinary banking business Share and debenture capital and long-term deposits may legitimately be used for the former purpose, but short-term deposits never "

(*c*) *Government Assistance*—I *Guarantee of Interest on share capital* was suggested with a view to inspire confidence in the public Some people suggested a limited guarantee for, say, five years and others a permanent guarantee to be revised periodically II *Guarantee of share capital* was advocated as it was thought that the bank would not be able to attract sufficient capital without it III *Guarantee of Principal of Debentures*—It would induce people to purchase debentures of the bank, but if there is some guarantee on share capital, guarantee on debentures is unnecessary as they will be issued on adequate securities A double guarantee is preferred by some people This guarantee should be limited for some years, but it was also argued by some that there should be no such

limit as the guarantee in case of business will last till it becomes a paying concern and different concerns financed by the bank will become paying concerns at different times IV *Guarantee of Principal of Debentures* "A powerful and well-directed stimulus is needed to start the economic development of India along the path of progress Such a stimulus can only be supplied by an organized system of technical, financial and administrative assistance" It is therefore, suggested that the Government should give a guarantee regarding the repayment of debentures V *Inclusion of Debentures in the list of Trustee Securities* The Indian Banking Committee are not in favour of it

(*d*) *Nature of Government Control*—Some restrictions should be placed upon the activities of the bank by the Government to ensure safety The restrictions proposed are (1) The bank should not lend more than a certain proportion of its capital to a particular industry (2) Advances should be made only after the expert gives a favourable report about the prospects of the concern (3) Applications from industrial concerns for loans should be entertained only when 50 per cent of the required capital of the concern has been subscribed and paid up with a view to avoid risk to the bank (4) The bank should satisfy itself that the management of the industrial concern is in the hands of expert managers (5) It was also suggested that the Government should exercise control over the bank by appointing one or two directors

(*e*) *Nature and Scope of Advances* —The bank can provide initial capital for industries in the form of a direct loan or by underwriting the share capital of the concern In case commercial banks do not provide working capital to industrial concerns, the proposed bank will take up this business also and it could also develop the cottage industries

Proposals of the Central Banking Committee

According to the Committee initial block capital should come from the public through shares and debentures and capital for extensions should come from reserve funds and failing that from issuing shares and debentures Commercial banks can be expected to supply finance for such purposes in the form of temporary advances on adequate security These loans should be repaid from the proceeds of shares or debentures "Further the ideal arrangement is that industrial enterprises should also provide out of their initial capital the minimum necessary working capital Any extra requirements of working capital over and above this minimum might be met by short-term advances by commercial banks which

will be entitled to require that the industrial enterprise maintains a safe and proper relation between owned and borrowed capital *

What Commercial Banks Should Do

The commercial banks can follow the policy of German banks by under-writing the shares and debentures of industrial concerns so that the public may have confidence in the concerns and may purchase their shares and debentures in course of time No technical experts on the staff of the banks are necessary for this purpose and to have business relations with industrial concerns, a commercial bank should have somebody on the management to be fully conversant with the financial side of the industries in general These banks' delegates will prove useful to industrial undertakings in view of their general experience in finance and will also be of advantage to banks themselves to protect them against losses This will also promote an atmosphere of mutual confidence But, of course, this new class of business requires much experience, a sound banking policy, considerable capital and a firm resistance to speculative tendencies The Imperial Bank of India on the establishment of the Reserve Bank might give a lead in this direction but the bulk of the smaller joint-stock banks in India having small resources are unfit for the business To establish an effective liaison between the bank and the industrial concerns it is necessary that the entire banking business of an industrial concern to be financed by the bank should be in the hands of only one bank

The Banking Committee recommend the appointment of Local Advisory Committees in Banks to create a sympathetic attitude of the banks towards industries These committees will provide reliable information to the banks regarding the

* The foreign experts who collaborated with the Banking Committee do not accept the position that industrial concerns in India should be expected to have their working capital supplied by commercial banks even if adequate security is offered ... Not only block but also normal working capital has to be furnished out of the firm's own capital and before the firm is fit for Industrial Banking it must have been in operation for a sufficient period to prove that it is strong enough ... We consider this as the sound arrangement so that the expressions "ideal arrangement" and "minimum working capital" ... seem too weak to us ... We understand by the "normal working capital" the capital which the industrial concern can employ during the whole year on the basis of its present capacity, whilst only the amount in excess of that normal capital needed in the busy season ... may reasonably be expected from bank credit If the whole of the working capital of an industrial concern is borrowed money part of the loan would become locked up, and the concern would never be free from indebtedness to the bank " See Appendix I to the *Central Banking Committee Report*, pp 610, 611 also Enclosure II, pp 631 632

status and financial position of their customers. The functions of these Local Boards should be purely of an advisory character, otherwise the responsibility of the bank management will be weakened. These advisory Boards will be selected by the Directors and the choice should fall on the leading men in business and industry.

Regarding the granting of loans on personal security, the banks in India are not in a position to do that and even in Western countries such loans are confined to very big firms. 'We cannot therefore recommend an indiscriminate extension of the system of granting clean credits by banks in India . . . .' But the banks should treat borrowers according to their integrity and financial position regarding loans and securities and if borrowers are of good standing so as to justify loans on personal security, this should be done.

At present Government securities are more popular than industrial securities because of the credit of the Government and the rates of interest offered by them. The fiscal policy of the Government is also responsible for this fact as the investors are not sure that the Government will guarantee protection against foreign competition. We think that a nationalization of the country's fiscal policy would . . . enable industrial investments to become equally attractive with Government security.

PROVINCIAL INDUSTRIAL CORPORATION

The Central Banking Enquiry Committee have recommended the establishment of a Provincial Industrial Corporation for every province with branches if necessary, and with capital initially or permanently supplied by the Provincial Governments concerned. But this creation is dependent upon the will and judgment of Provincial Governments.* To what

* Mr Sarker makes the following remarks in his *Minute of Dissent*: 'I am convinced that the establishment of industrial banks is not only desirable but absolutely necessary. I regret that my colleagues have been led to make their recommendation vague and perhaps misleading. For as the recommendation now stands it seems to imply that the case for the establishment of such institutions has still to be proved before the Provincial Minister takes any action. The Industrial Commission which considered the matter in 1918 . . . recommended the constitution of an expert committee to consider the question of the establishment of industrial banks for financing industries in India. The Banking Committee which is surely an expert committee . . . would be failing in its duty if it did not unequivocally press for the establishment of industrial banks in the provinces the need for which has been emphatically pressed by all the Indian witnesses . . . I do not think therefore that it will be necessary for the future ministers in the provinces where the banking committees have recommended the creation of industrial banks to go over the same ground . . . as we have traversed.' See his *Minute of Dissent* pp. 535-536. He therefore definitely recommends the establishment of Provincial Corporations immediately in Bombay, Madras and Bengal.

industries should help be granted is solely to be determined by the Corporation and the Government 'We think it undesirable to fetter in any way the discretion of Provincial Governments in a matter which is of fundamental importance from the point of view of provincial development by suggesting hard and fast criteria for the grant of assistance by the proposed Corporation At the same time we hold that the advisability of giving assistance in any particular case should depend on the extent to which the enterprise will be of benefit to the public, and will add to the productive power of the province and provide employment for its people, and not merely on its probable advantage to the promoters of the industry '

The share capital will vary from province to province according to industrial needs As far as possible it should be obtained from the public, and failing that the Committee have recommended that the Government should purchase as much of the capital as is not purchased by the public This method is preferable to the guarantee of dividend on share capital The share capital should be supplemented by debenture capital[9] which should not be more than twice the amount of share capital in the beginning, and to make the investment attractive the Government should guarantee interest on debentures for a limited period If necessary, the Government might also purchase a portion of debentures until a regular market has been created for them The Committee reject the idea of the debentures of the Industrial Corporation being classed among trustee securities

The Industrial Corporation can also secure resources through long-term deposits from the public for a period of not less than two years Short-term finance will be obtained by industrial concerns from existing institutions The money so obtained should not be lent out for longer periods than the currency of the deposits This proposal that deposits for less than two years should not be accepted by the Corporation is designed to prevent competition with private joint-stock banks So long as the Government is interested in the Corporation through subscription of share or debenture capital, or through guarantee of dividends or interest on such capital, it should be represented on the Board of Directors of such Corporations The Government nominee should not have the power of veto,

---

[9] Debenture issues should not exceed the amount of the outstanding long term loans, and must not be more than five or six times the amount of share capital This would secure good profits to the Corporation and the debentures at all times would be covered by long term secured loans and the additional security provided by capital to the extent of 20 per cent of debenture issue will be enough

but he should be entitled to ask for a reference to the Government if he does not agree with the views of the board on important matters. By-laws should be framed by the Corporation giving the conditions under which it may grant loans to industrial concerns. This will ensure that the business of the Corporation is conducted in a fair and impartial manner. During the currency of the interest of the Government such by-laws should require the sanction of the Government.[10]

AN ALL-INDIA INDUSTRIAL CORPORATION

This institution can secure proper liaison in the matter of finance and a direct connection with the large spending departments of the Central Government and correlation of industries with railway rates, customs and stores purchase policies of the Government. This question is to be finally decided by the demands of the Provincial Governments requiring the services of such a Central Institution or by the Central Legislature. For some time at least there will not be national industries of such importance in so large a number as to justify the establishment of such a Corporation to enable it to invest its funds remuneratively and the existing national industries can be financed directly or indirectly by the Federal Government. It will therefore be a long time before the establishment of such an All-India Corporation will be justified. But the co-ordinating and supplementary functions proposed to be entrusted to the Corporation will be there. For these reasons an All-India Industrial Board with advisory functions is to be recommended. It should consist of the Government Members of the Industries and Finance Departments, representative businessmen connected with finance, banking, commerce and industry and representatives of Provincial Industrial Corporations.

ITS FUNCTIONS

The Board can take up periodical surveys of Indian industries and suggest the true lines of progress by avoiding over-production. It can help the Provincial Governments in preparing their programmes of industrial reconstruction and it will thus be able to avoid unnecessary inter-provincial competition in particular industries. It can render services regarding the collection and dissemination of industrial intelligence so very useful to all provinces. In Europe and America such statistics of production are being compiled which enable governments to follow definite credit and currency policies, and in India this work can be entrusted to the All-India Board. It

---

10 See *Minute of Dissent* of Mr. N. R. Sarkar, pp. 511-515, where he lays down certain functions of the Corporations and suggests precautionary measures for controlling their practices.

can maintain a staff of experts, keep up to date the results of industrial surveys by studies and researches conducted by experts give suitable advice to the corporations regarding issues of debentures, etc., can guide the general policy of the Provincial Corporations in making investments in securities of industrial corporations, and it can advise the Government and Provincial Industrial Corporations with regard to the floating of inland and foreign loans It can enquire into the organization of Indian industries and make suitable recommendations thereon The Government can depend upon it for advice on commercial and industrial education on proper lines, and it can also formulate some schemes for drawing out small savings for industrial investments Most of all it can emphasize upon the Central Government the need for formulating their fiscal, financial, railway rates and stores purchase policies to suit the interests of Indian industries and suitable action for advancing the interests of industries in general can be undertaken by the Board

CHAPTER IX

The Managing Agency System

THE managing agency system occupies a very important place in the financing of industries in India There are firms of outstanding reputation which bring new industrial concerns into existence, draw up the memorandum and articles of association and perform the other preliminary operations They also define the voting powers of the shareholders and reserve ample powers for themselves in order to exercise control over the concerns they manage The following table, including a list of the managing agents of Calcutta, shows the extent to which industries are controlled by the system —

Name of Managing Agents	No of Companies Managed	Jute	Tea	Coal	Electricity and Engineering	Transport	Sugar	Other Industries
Andrew Yule & Co	54	10	18	14		3	1	8
Duncan Bros	25	1	24					
Martin & Co	22			7	6	8		1
Octavius Steel & Co	20		13	1	5	1		
Begg Dunlop	17	4	13					
Bird & Co	18	8		3	2	5		
McLeod & Co	17	5	6			6		
Gillanders Arbuthnot & Co	17	2	5	3		6		1
Williamson Magor & Co	17		16	1				
Shaw Wallace & Co	16		7	6				3
Jardine Skinner & Co	16	4	6	4				2
Kilburn & Co	15		9	3	2	1		
Davenport & Co	14		14					
H V Low & Co	13			12				1
Balmer Lawrie & Co	12			2	5			5
F W Heilgers & Co	11	2		8				1
McNeill & Co	10	1		8				1
Killick Nixon & Co	9				2	7		
Begg Sutherland & Co	8				1		5	2
Villiers, Ltd	6		3	3				
Kettlewell Bullen & Co	6	2	1					3
Geo Henderson & Co	5	2	3					
Birla Bros	4	1						3
Jas Finlay & Co	4	1	3					
Thomas Duff & Co	3	3						
Other Firms (11)	26	6	6	4	6	3		1
Total	385	52	147	79	29	40	6	32

The system is a peculiarly Indian phenomenon, having no parallel in any other country of the world In its origin, it

is a continuation of the large trading houses which carried on banking, industry and other activities indiscriminately. The promotion of the cotton textile industry in India is almost solely due to the managing agency system. The pluck and enterprise of the early Parsee founders of the cotton mills in India deserves admiration. The firms of secretaries and agents had a very large stake in the capital and fortunes of cotton concerns and their services in the initial stages of the cotton industry, specially in Bombay and Ahmedabad, were praiseworthy. Even now, firms of managing agents play a predominant part in the promotion of various industries in India.

In Bombay, when an industrial concern, particularly a cotton mill, is started, the managing agents raise capital from persons who trust them. The working capital is obtained from private deposits and cash credits from banks. The deposits are for six to twelve months and bear interest at about 4½ to 6½ per cent which to a great extent depends upon the position of the mill and the standing of the managing agents. Loans from banks are obtained on the guarantee of the managing agents and now the liquid assets of the concern are hypothecated to the bank. When the Imperial Bank of India grants loans on the strength of promissory notes, the latter must bear two signatures, and thus the personal guarantee of the managing agents is also taken. This is not necessary when loans are obtained against government and other trustee securities. In some cases the managing agents provide finance in case they are appointed agents for buying raw materials and selling the products of the industry.

In Ahmedabad, the system has been admitted to be an unqualified success. The total block capital, required for starting a cotton mill in Ahmedabad, is Rs 20 lakhs of which Rs 5 lakhs is initially raised by share capital, and the balance is raised in the form of seven-year deposits for Rs 5 lakhs and the remainder Rs 10 lakhs is raised either through one-year deposits or found by the managing agents themselves. The seven-year deposits are attracted by the device of granting a share to the depositor in the agency commission. The managing agency is made into a limited concern with a nominal capital of Rs 1,000 divided into 1,000 shares of rupee one each. A person who is prepared to deposit Rs 5,000 with the concern is given one share of the agency company and he is thus entitled to one-thousandth part of the agency commission. The value of this one rupee share in the market is often about Rs 700 to Rs 800. These shares can be sold off by the holders at their will.

The deposits received by the mills mostly come from individuals and vary on the average from Rs 5,000 to Rs 10,000. Before the War, all the deposits used to come from the public

in Ahmedabad or the adjoining villages but after the War some of the concerns have accumulated reserves and these reserves are now inter-deposited. The deposits from rural areas have fallen because of the fall in the prosperity of the people and because of Government competition. The Ahmedabad public regard a deposit with a mill company safer than with a bank because of the business integrity of the managing agents. In Ahmedabad mills get little assistance from banks because the latter are not prepared to invest their short-term resources in block capital and the former are unwilling to pledge their stocks for advances for short periods as this would ruin the whole fabric of their credit. The managing agents get a commission for selling the products. The rates of interest offered on deposits in Ahmedabad were as follows for a number of years:—

		Per cent
——	1923	6
May	1926	5½
January	1927	5
October	1929	5½

The rate which the managing agents charge on advances made by them is never more than 6 per cent. and compares favourably with rates on deposits because the amount they can be called upon to advance may sometimes be very large. The following statement shows how the mills of Ahmedabad and Bombay get their finance:—

(In Lakhs of Rupees.)

	Bombay Figures of 64 Mills Rs.	Percentage of total finance	Ahmedabad Figures of 56 Mills Rs.	Percentage of total finance
Amount loaned by the managing agents	5,32	21	6,64	24
Amount loaned by banks	2,26	9	42	1
Amount of public deposits	2,73	11	4,26	39
Amount of share capital	12,11	49	3,40	32
Amount of debentures issued	2,38[1]	10	8	1

It will be noticed that the amount of public deposits and the amount directly loaned by managing agents are far more important than the amounts loaned by banks. The system of public deposits specially in Ahmedabad is commendable and without it the industry would not have made as much progress as it has done. Like many other elements in Indian economic

[1] Made up of:—46 from managing agents, 53 from banks and 139 from the public.

life the system is doomed In times of depression public deposits fall and the concern may come to grief From the point of view of the depositor the investment is safe as long as the concern may be well-equipped and well-managed, but being an unsecured creditor, the depositor might stand to lose

In Calcutta the managing agency system mainly prevails in jute, coal, cotton and tea industries where the powers of managing agents are very wide They are the founders of the concerns, arrange for the finance in various ways, purchase the raw materials, supervise the manufacture, sell the products and conduct the management of the concern in all possible ways They also give the guarantees when banks so require, but the guarantee in Calcutta is merely this that the overdrafts granted are always covered by stocks

In Bihar and Orissa the managing agents are most active in the coal mining and iron and steel industries Of the lesser industries they support most of the electrical enterprises the lime factories and the larger mica mines and a good part of the sugar industry Their disadvantages from a purely provincial point of view are that ' they have concentrated mainly on industries dependent on the exhaustible resources of the province and have not save in the matter of sugar, developed other industries, not so dependent (See *Bihar and Orissa Banking Committee Report*)

Though the managing agency system has done a great deal for the industrial development of the Bombay province it has serious drawbacks In many cases managing agents, in addition to managing their mills, have traded and speculated and the consequent weakness of their position has reacted upon the finances of the mills because banks have recalled loans even from sound industrial concerns owing to the deterioration in the financial position of the managing agents It is true that in times of crises, they have incurred extensive losses as a result of financing the mills under their control, but in many cases these loans have been turned into debentures and the control has passed on to them in place of remaining with the share holders who have lost all their capital invested in industries The managing agency system works well in good times when the managing agents may themselves supply finance In bad times, however, the managing agents are not able to cope with the financial requirements of the industries

Mr Manu Subedar, in his *Minute of Dissent* to the Central Banking Committee Report, summarises the disadvantages thus The system is old-fashioned and it has outlived its utility It is disadvantageous to the shareholders, whose interests always come second to those of the managing agents It has now held the field in industry to an alarming extent

New industrial capital could be drawn and new concerns could be promoted with ease only through the great established firms of managing agents Outside of them they would have an uphill task This is not a healthy situation as it does not augur for extensive development of industry Managing agents have contracts with provision not only for long periods, but for their perpetual renewal and often the managing agents could not be got rid of, except when they resign Some of the contracts involve payments to them on purchase for the company, and some on sales and some on both In some cases the managing agents get their commission on production without any reference to the condition of the company" In this way a large portion of the profits of the concern are absorbed by the managing agents and the industry is made less attractive to the investor Hence the system checks the flow of capital into the industry They speculate on the stock exchanges in the shares of their own concerns and take advantage of a rise of prices "to boom their shares and unload them at top level, leaving the public to hold the baby" In this way they give to industry a bad name The managing agency contracts are sold without any reference to shareholders and the shareholders, who have purchased the shares on the personal reputation and efficiency of some partners in the firms of managing agents, find their investments in the hands of young and incompetent hands who may be completely unfit to carry on the work The managing interest often represents promoter's charges which ought not to be a drag on the enterprise for ever It sometimes represents a capitalized goodwill which a new party purchases with the idea that he gets a full right to use the concern to his advantage within the law With the passage of time, it is inevitable that under the system the concern should pass on into incapable hands and involve Indian industry into bad times

The Bombay Shareholders' Association, in its memorandum before the Tariff Board complained that the extraordinary powers conferred upon the managing agents turned them from managers into masters and that the supervision of the board had become a farce The gathering of personal interests around the orbit of mills militates against the attainment of internal economies and improvements in organization It was urged by the association that office allowances and commissions on production and sales should be abolished and that the commission on profits should be confined to business profits only and should be charged on profits after providing for depreciation Objection was also taken to the clause empowering the agents to obtain compensation in case of winding up References were made to cases where managing agents required thier companies to convert their rupee indebtedness into gold dollar

liabilities, thus involving the companies into an extra liability of about Rs 85 lakhs on the basis of the prevailing rate of exchange Cases were mentioned to show how managing agents acting as selling agents had utilized for their personal benefit the funds of their companies The managing agents do not refund to their mills commission or rebate on insurance. (See Bombay Shareholders' Association's Memorandum presented to the Tariff Board)

It is thus clear that attempts should be made to make industrial enterprises in India less dependent on the system for future development The foreign experts who collaborated with the Indian Banking Committee write " The managing agency system is open to criticism There ought to be still another financial agency to meet the requirements of industrial firms, which would make industry less dependent on that institution A company with a proper board enjoying friendly sympathy and banking advice, ought to be in a position to manage its own affairs " (See Enclosure II on page 635, *Central Banking Committee Report*)

The system of the transfer of control of industry by heredity or by sale without the consent of the shareholders to parties not approved of by them must be put an end to by law and when the Indian Companies Act is revised, reforms should be made in this direction Further, the managing agency contracts should be limited to a certain number of years and should be good during that period only Some restrictions will have to be placed on the existing agencies Speculation in the shares of the mills managed by the managing agents will have to be stopped to promote the flow of capital into industry In paragraph 693 of their Report the Indian Banking Committee write " We, accordingly, recommend that the Bank Act should prohibit the organization of a bank on the managing agency system and provide further that any arrangement made subsequently for conducting the management of a bank under such a system shall be void The object we have in view is to prevent long-term agency contracts being given to firms or individuals creating, so to say, a hereditary title to the agency "

CHAPTER X

The Managing Agency System

(Continued)

THE working of the managing agency system with particular reference to cotton mills has been examined in some detail by the Indian Tariff Board, 1932 The main features of the system have been enumerated in their Report as below —

(1) *Period of Agreement*—In Bombay and Calcutta a managing agency agreement is fixed for a specified initial period at the end of which the discontinuance of the agreement is dependent on an extraordinary resolution of the company to that effect The usual period of the agreement varies from 30 to 40 years in Bombay and from 10 to 20 years in Calcutta In Ahmedabad the agreements are not subject to any time limit and are generally described as being permanent and non-changeable

(2) *Payment to Agents*—The payment consists of an office allowance fixed on a monthly basis and also of a commission based generally on a certain percentage of the profit The office allowance is intended as a contribution by the constituent company towards the expenses incurred on its behalf at their head office by the managing agents In Bombay the allowance exceeds the actual out of pocket expenses and assumes partially the form of an additional remuneration to the managing agents The profit on which commission is calculated is taken to mean gross profit before making provision for depreciation There is no office allowance in Ahmedabad and the payment consists of a commission on sales and in some cases on production which may be fixed according to the option of the agent at a certain percentage of the value or at a definite amount per unit In Bombay the commission is subject to a certain minimum ranging from Rs 6,000 to as much as Rs 1 20 000 per year

(3) *Subsidiary Services*—The managing agent is entitled to work for and contract with the company in respect of various services such as purchase of materials, the sale of finished goods, the insurance of building, plant and stock, etc , for which additional remuneration is received by the agent

(4) *Control by Directors*—The managing agent is subject to the supervision of the directors of the company in respect of the work of managing the company's business The duties and obligations of the managing agents are stated in

detail in the agreement and the residual power is vested in the directors In some cases the residual power is conferred on the managing agent

(5 *Nomination of Directors by Managing Agents*—The managing agent has the right to nominate one or two persons for appointment on the board of directors of the company

(6) *Agent's Claim to Compensation*—The managing agent has the right to continue in office if the business of the company is transferred during the pendency of the agreement to another party In case of refusal he is entitled to claim compensation In case a company is wound up, the managing agent is entitled to claim compensation on a scale equivalent to the commission earned by him during the previous five years In many cases the managing agent is also entitled to compensation if the agency is terminated by mutual agreement

(7) *Assignment of Interests and Functions*—In Bombay and Ahmedabad the agreements provide that the managing agent may assign to a third party his interest or duties under the agreement without the sanction of the directors In some cases the agreements provide that the managing agent can assign at his will not only his interest in earnings but also the whole agreement

It is necessary to point out that a description of the managing agency system based on agreements and articles of association does not necessarily correspond with the system as it is found in actual operation "and that unless the account given above is qualified with reference to its actual working, the impression conveyed may be misleading Since the principal criticisms directed against the system refer rather to its actual working than to its technical features, it is to this aspect of the question that we desire mainly to devote our attention In doing so, it is necessary first of all to refer to the functions performed by or attributed to managing agents in the industrial economy of India" (*Report of the Indian Tariff Board* 1932, page 81)

FUNCTIONS

It is said that managing agents perform three main functions firstly, the pioneering of new industrial enterprises in the sense of prospecting, research, etc, secondly, the provision of finance and thirdly, the day-to day management of industries. Regarding the first function it may be said that leaving out a few industries brought into existence by the Government, nearly all big industrial enterprises owe their existence to the enterprise of managing agents The leading managing houses still maintain a tradition of healthy and cautious development of industries, which is one of the most important influences favouring the continuance of the managing agency system

in this country Of course, every managing agent cannot claim the ability prudence or resources of the great business houses by which the system was founded In the case of nearly all well established industries in the country, there is no longer any necessity for the services of a special agency for the work of pioneering and initial development The first of these functions has, therefore, little application to the well-established industries under the present circumstances

The provision of finance is the principal service rendered by managing agents They lend money to mill companies under their control from their own resources and loans from banks are almost invariably secured on the signatures of managing agents The lending banks require two signatures in connection with loans that they advance and this practice is so general as to necessitate the services of the managing agency system It is through the managing agent that the public deposit system has been very successful in Ahmedabad In several cases a considerable part of the share capital is held by the managing agent himself "It will be seen, therefore, that taking conditions as they are, in the great majority of cases the managing agent plays so important a part and holds so large a stake in the provision of finance that his presence must be regarded as indispensable to the industry"[1]

The conditions which are indispensable for the financing of the industry according to the managing agency system will lose their force under two circumstances, firstly, if the banking system of India is so re organized as to meet more adequately the financial requirements of industries and secondly the State may grant protection so that investment will be more attractive than in the past In this connection the Report of the Tariff Board referred to above remarks that "Both these are for the present hypothetical conditions and their possible reaction on the usefulness of the managing agency system it is impossible to forecast It has been suggested that if before a new company is allowed to be started, it is laid down as an obligatory condition that a reasonable proportion of capital against working expenses should be provided in the form of subscribed capital, the services of a managing agent will become of much less importance to a company This is undoubtedly so But the proposition assumes either that the necessary proportion of working capital in addition to fixed capital can ordinarily be provided by means of share capital or that it is better to restrict industrial development than to permit the formation of more companies on the present lines Neither of these assumptions can be accepted as valid

[1] *Report of the Tariff Board* regarding the grant of protection to the cotton textile industry, 1932, para 71

under present conditions. In our experience of Indian industries, we have seldom come across a case in which sufficient funds for working as well as fixed capital have been found in the form of paid up share capital, even where a firm is started under the auspices of a reputed managing agent." (Page 8, of the Report.)

DISADVANTAGES OF THIS SYSTEM OF FINANCE

The financial methods of managing agents are unsound because they provide finance on wrong lines. It is because the proportion of short term funds in the total capitalisation of the companies renders their finance exceedingly unstable. The Tariff Board do not seem to agree with this view as is clear from the following statement in their Report on page 81 :—

"Although theoretically the system is from a financial point of view unsound, it seems to have effectively stood the test of experience up till now. The evils of the system will not be apparent so long as the management is in careful and competent hands and is able to show successful results. But once this condition ceases to apply, the system will inevitably break down. Like many other aspects of the managing agency system the success of its financial arrangements depends largely on the personal factor. Unless this is borne in mind no judgment regarding the managing agency system can be other than misleading."

The practice of inter-investment of funds among concerns under the same management is disadvantageous. Surplus funds or funds raised on the credit of one company may be invested in other companies under the same managing agents. Debentures issued by one company may be subscribed to entirely or mainly by other companies in the same group or in which the managing agent has an interest. The Tariff Board condemn this practice in the following words :—

"There is in our opinion little justification for a practice of this kind. Not merely does it involve serious unfairness to shareholders in the concerns whose funds are thus transferred but the practice often tends to the perpetuation of thoroughly insolvent concerns which it would be to the interest of managing agents and of the industry as a whole to have closed down."

The managing agent is substantially interested in the share capital of the company. The proportion of the total share capital held by Ahmedabad agents is generally 10 to 50 per cent. In this respect two general considerations are involved. First, the larger the holding of a managing agent in the share capital of the company, the closer the identity of his interests with those of the company. On the other hand, where the bulk of the capital is held by the managing agent, the rest of the

shareholders are left with hardly any effective voice in the management of the company, the control of which remains entirely with the managing agent. Under such circumstances, if the management is in inefficient hands, the preponderant holding of a managing agent may prove disastrous for the company because the voice of the shareholders is ineffective. Where the managing agent represents a high standard of ability and sense of responsibility, it may make little difference to the company to what extent the managing agent is interested in the share capital of the company.

The third function of the managing agency is associated with the day-to-day management of the industry. Much of the criticism against the system refers to the manner in which the current management of mills is carried on. The main aspect of the current management of mills which has come under criticism is the way in which managing agents have discharged their obligations in respect of various subsidiary services undertaken by them. It is an inevitable feature of the managing agency system that the agent may contract for the performance on behalf of the company of such services as the purchase of materials and machinery, the sale of finished goods, the insurance of fixed and liquid goods etc. This may lead to a conflict of interest between the agent and the company which in practice may amount to the subordination of the interests of the company to those of the agent. The managing agent may have a financial interest in the supply, sales or insurance agency as the case may be. The Tariff Board have summarised these defects as below:—

"It is, however, a legitimate inference that a situation in which a managing agent is financially interested in services performed by him for his company is one which may lead to serious abuse. The abuse may occur in various directions. In purchase of materials, stores and machinery it may take the form of purchases at unreasonable times, in excessive quantities and without due regard to quality, suitability and comparative cost. In sales of finished goods, where the selling agent is required to guarantee the mill against losses on outstandings, it may lead to slackness in enforcing the obligation of the selling agent and consequent accumulation of outstandings. In respect of insurance, it may prevent the mill from taking advantage of the low rates of premia which may prevail at times of intense competition among insurance companies and in cases where the managing agent is interested in a foreign insurance company, it may prevent the mill company from supporting Indian enterprise if it wishes to." (Para 75 of the Report.)

The benefit of any discount, rebate or commission which the managing agent may receive on account of purchases, sales

or insurance on behalf of the company properly belongs to the company. Except some out of pocket expenses, the whole of this benefit should be credited to the company's account.

The way in which managing agents are remunerated is also open to criticism. The Tariff Board in 1926-27 pointed out that payment by commission on profits was the most satisfactory method of remuneration[2] and the Tariff Board of 1932 concur in this view as follows:—

"Taking managing agents in India as a whole we believe that the prevailing practice as well as opinion among them favours this system of payment except in cases where specialized service is required or where the maintenance of output happens to be a factor of prime importance. ... A point in this connection which has been debated before us a great deal is whether the profit on which commission is calculated should properly include depreciation or not. The ideal practice is to regard profit strictly as nett profit and to estimate the managing agents' remuneration with reference to it. It would be more in harmony with the true nature of depreciation as a charge on production to exclude it from profit before the latter is divided between the managing agent and the shareholders. The point however does not appear to us to be of any great practical significance since it is generally admitted that if profit were taken to mean nett profit it would be reasonable to allow the managing agent a higher rate of commission than is allowed under existing arrangements." (Pages 87, 88 of the Report.)

The question of office allowance is a very controversial point in connection with methods of payment. Office allowance as a separate item of payment does not occur where the remuneration of the managing agent is based entirely on sales or production. Mostly it occurs where the remuneration is calculated as a commission on profit. It should be regarded as an allowance towards expenses incurred in maintaining the office and not as a form of remuneration. "The idea which prevails among some managing agents that the office allowance or some portion of it may be regarded as an additional remuneration for the agent is to be deprecated."

There is another weak point in this system of management that a managing agent is often in charge of more mills than he can effectively control and it is, therefore, difficult to give adequate attention to the details of management. This is more true in Bombay than elsewhere. In Ahmedabad the number of mills under a single managing agent is usually fewer than in Bombay and the managing agent is consequently in

2 *Report of the Tariff Board*, 1926-27, page 87.

closer personal touch with the affairs of his mill The Tari Board in 1926-27 observed that that was one reason wh Ahmedabad had fared so much better than Bombay Th point seems to be independent of the managing agency syste as it may arise under any system of management "Bett results are likely to be attained from close personal attentio than from large-scale production or management and it significant that most of the irregularities brought to our noti have occurred in mills included in large groups"

Regarding the existing practice of transferring intere in the managing agency agreement the Tariff Board recomme that this "should be subject to the approval of the sharehol ers No transfer of the agreement itself should be valid wit out the consent of the company There is little justificati for the payment of compensation to the managing agent on t winding up of the company" (Recommendation 57, pa 281 of the Report)

The mere fact that objectionable features are prese in an agreement does not necessarily mean that the syste operates badly in that case The Tariff Board point out th agreements are drafted by lawyers who make extravaga provision for the safety of their clients But the fact th abuses do exist cannot be controverted These abuses c best be checked by the influence of the better managing agen themselves and of the Millowners' Associations, and by increa ed co-operation between managing agents and associatio representative of the interests of investors

The Tariff Board recommend that though in the last reso the most effective means of checking the abuses of the mana ing agency system is organized voluntary action on the part those concerned it is necessary to supplement it by legislati measures The unduly long periods for which in many cas managing agents are entitled to hold office unconditional may render them free of control for all practical purposes In the discharge of his duties the managing agent is subject to t control and supervision of company directors, but as this contr lacks the sanction of removal from office, it may prove ineffe tive in case of serious incompetence Legislation is, therefo desirable in order to define the extent and nature of the contr and supervision to be exercised by the directors and shar holders of the company over the managing agent

The Tariff Board have emphasized the appointment at early date of a committee to report on the manner in whi the Company Law should be amended The relevant porti of their recommendation may be quoted in this connecti which is as below —

"We consider that a committee representative of the various interests concerned should be appointed as early as possible to enquire into the necessity for amending the Company Law in this regard. We recognize that a good deal of preliminary investigation will be required before final decisions are arrived at. The State has an inherent duty in every country to safeguard the interests of investors and this duty is rendered more imperative whenever a policy of protection is in force. Unless reasonable steps are taken to ensure that the investor shares the benefits of protection the progress of industries which is bound up with the confidence felt by the investor will be necessarily hampered. We, therefore, think that there should be no avoidable delay in instituting the enquiry we have proposed." (Para. 82 of the Report.)

CHAPTER XI

Financing of Foreign Trade

INDIA's total import and export trade amounts to about Rs 600 crores a year. The bulk of this trade is in the hands of non-Indian banks which are about 18 in number. Two of these, Messrs Thomas Cook & Son and the American Express Company Incorporated deal mostly with tourist traffic and the Chartered Bank of India, Australia and China, the National Bank of India, the Mercantile Bank of India, the P and O Banking Corporation and the Eastern Bank have a considerable portion of their business in India. The remaining eleven are branches or agencies of large banking corporations doing a major portion of their business abroad. Eight of these have their head offices in England, three in Japan, two in Holland, two in the U S A, one in France, one in Portugal and one in Holland.[1]

The following table gives figures relating to their deposits and cash balances in India for a series of years[2] —

	No of Banks	Capital Reserve and Rest	Deposits in India	Cash Balances in India
		£ (1,000)	£ (1,000)	£ (10,000)
1913 (Pre-war Year)	12	37,825	23,276	4,411
1919	11	53,070	35,769	22,487
1920	15	90,217	56,105	18,881
1921	17	111,632	56,397	17,675
1922	18	112,221	55,038	12,132
1923	18	140,103	51,332	10,859
1924	18	130,464	52,976	12,275
1925	18	138,311	52,909	7,062
1926	18	148,003	53,658	8,046
1927	18	180,919	51,647	6,098
1928	18	187,923	53,354	6,012

The financing of this foreign trade generally consists of two operations, *viz*, (1) The financing from the Indian port to the foreign port or *vice versa*, and (2) the financing from or to the Indian port to or from the up country distributing or collecting centre.

[1] *Central Banking Enquiry Committee Report* pp 310 and 311
[2] *Ibid*, p 311

With regard to the second operation, i.e. the financing from, or to the Indian port to, or from the up country distributing or collecting centre the process is different. The export trade or the movement of the produce from the village to the *mandi* is financed by zemindars, money lenders, indigenous bankers and co-operative societies. The Imperial Bank and the joint stock banks also help in financing in villages, because they lend money in *mandis* against stock in the godowns of commission agents and exporting houses. The latter in turn lend to village producers against the latters contracts to deliver goods at subsequent dates. The exchange banks take a direct part when the produce is moved from the *mandi* to the port. In *mandis* the exporters take delivery of the produce through a *Shroff* who finances the payments and gets a commission of ¼ to ½ per cent over the transaction. The *shroff* is paid by means of demand drafts on the exporter's firm at the port and signed by the firm's representative at the inland centres. These drafts are purchased by the Imperial Bank, the indigenous bankers and the exchange banks, and the *shroffs* thus get money to finance further transactions. The import trade from the importing centres to the distributing centres in India is generally financed by commission agents, *shroffs* and Indian joint stock banks. At important centres like Amritsar, Cawnpore and Delhi the D P drafts are usually paid on or before maturity by the importers. They get loans from the exchange or joint stock banks against a margin of 20 per cent of the value of the goods *plus* all import charges and have to pay interest at the Imperial Bank rate.

The exchange banks also finance the imports of gold and silver bullion. The majority of the Bombay bullion importers are members of the Bombay Bullion Exchange, Limited. These dealers place orders directly or through the exchange banks. As soon as an advice is received from London or New York of the purchase of bullion, arrangement is made with an exchange bank for remittance by purchasing a bullion T T. This contract between the bank and the dealer is made through certified brokers. The bank is instructed by the dealer whom to pay in London or New York against complete shipping documents. The bank instructs its agents to make the necessary payment. As the bullion arrives in Bombay, the bank clears the consignment and stores it in its strong rooms and the dealer has to take delivery within seven days. Interest at the Bank of England rate, subject to a minimum of 4 per cent per annum, is payable from the date of payment in London or New York to the date of payment in Bombay.

Inability of Indian Banks

Indian joint-stock banks are not legally prohibited to take part in the financing of foreign trade. When the National

Bank of India was established it did take up the business Some of the now defunct Indian joint stock banks have at one time or another done this business and the instance of the Alliance Bank of Simla which failed in 1923 may be cited as an illustration During its six years' career the Tata Industrial Bank also took up the foreign exchange business freely The main reasons why Indian joint-stock banks do not undertake this profitable business are as follows —

(1) The competition of well-established non-Indian exchange banks with huge reserves and capital

(2) The absence of branches of Indian banks at important financial centres in foreign countries which prevents them from taking part in arbitrage and direct exchange business

(3) The employment of Indian banks' resources in internal trade

(4) It is difficult for an Indian bank to establish a branch in London, because the bank must have a very large capital to command credit in the London discount market, and it should be in a position to bear a loss of Rs 5,000 every month for at least three years [4] It must have a trained and reliable staff with knowledge of international exchange, and the floating resources of the bank should be large enough to permit a big turn-over The bank can hardly expect to receive in London local deposits or other business from the British public Besides the above difficulties, exchange banks in India have been so well established and so well provided with funds through their Indian branches and the London discount market at cheap rates that it would be difficult for an outside institution to compete with them Some of these difficulties are such that they cannot be removed even by the Government

The Imperial Bank is prohibited by its charter to undertake the business of financing foreign trade apparently because it holds Government balances and should not take up risky business

Rupee Import Bills

The bulk of both imports and exports is financed by means of sterling bills In case of exports, it is to the advantage of the Indian trader to draw bills on London so long as credits can be opened there and in this way have access to the discount facilities at the international financial centre In the case of imports, a very small part of the trade is financed by bills which get the advantage of the London money market, because the import bills are mostly D P drafts Rupee bills should, therefore, be introduced in this connection The exchange banks' representatives say that this is a matter of settlement between

---

[4] *Central Banking Committee Report*, p 312

the exporter and the importer and that the bulk of the import bills coming out are for relatively small amounts, and in their case the chances of creating a discount market are not great ” It should be said that the present time is very opportune for insisting on rupee import bills being drawn because the foreign manufacturers are very keen on disposing of their manufactured goods in India

The foreign experts pointed out in this connection that the improvement in the inland bill and money market was the primary problem to be solved before progress to an appreciable extent could be expected in the use of rupee bills for settling foreign transactions These bills will be drawn in the currency of that country where the interest rate was the lowest and the best discount facilities were provided Both these conditions are wanting in India at present Under such circumstances, enforcing foreign exporters to draw rupee bills would hamper trade and industry by raising the cost of imported goods

The foreign experts assumed that India s import trade was financed in the cheapest way but this assumption is unjustifiable Import bills are mostly 60 days D P drafts on which the Indian importer has to pay interest usually at 6 per cent from the date of the bill to the date of the arrival of the proceeds of the bill in London This rate is raised when the Bank of England rate is above 5 per cent It is thus clear that the rate paid by the Indian importer is not based on the open market rate of discount in London and so long as this state of affairs continues the natural bill market for the import business of India is India and not England Further, the change banks should change their method and accept the ls instead of purchasing them

Acceptance Credit

As regards the export trade, the system of bank acceptance credit should replace the cash credit system prevailing at present in India as the latter is inelastic and interest is charged generally on at least half the amount of the loan whether it is fully taken advantage of or not Under an acceptance credit the exporter would draw on the bank for the amount of the credit

---

[5] This contention of the exchange banks that these bills are in very small amounts and are of no use for a discount market cannot be conceded If the exchange banks can lend as much as 30 crores to Indians on their local advances, including advances against import bills in spite of the bills being in small amounts, surely a discount market could do the same and if it wanted to borrow on them, it might rediscount them in parcels to make up sufficiently large amounts It is not, therefore, the size of the bills which stood in the way of the creation of a discount market in India but the reluctance of the banks to part with the profits of the business ' Mr N R Sarker's *Minute of Dissent*, p 538

and this 'would make it possible for him during the life of these drafts to send the goods forward, drawing an export draft on his customer and offer it for sale to his banker in liquidation of the obligation at the maturity of the rupee draft to which the banker has given his acceptance under the credit. This would considerably lighten the burden on the exporter during the period his merchandise is stored.'[6] This is what America did after the war. In India acceptance credit is used only to a limited extent for the following reasons:—

(*a*) the practical non-existence of documents of title such as warehouse warrants and railway receipts in suitable form,
(*b*) the efficiency of the cash credit system,
(*c*) the high stamp duty on bills, and
(*d*) the difficulty of introducing a suitable bill form for the whole of India.

EXISTING FACILITIES

The Exchange Banks' Association informed the Central Banking Committee that 'merchants are at present able to obtain from the exchange banks all the assistance they require to finance their export and import trade provided they are of good reputation and possess means in reasonable proportion to the trade that they do.' They further said that no solvent business-man experienced any difficulty in obtaining finance only if he furnished the necessary information in the form of a balance-sheet, and a suggestion was made that Indian business-men should adopt the business-like practice of having their books regularly audited by a recognized auditor and a balance-sheet in correct form drawn from time to time.[7] The Indian merchants,

---

[6] Memorandum submitted to Indian Banking Committee by Sir Basil Blackett.

[7] This demand relates to 'Balance Sheets and Profit and Loss Account' audited by auditors approved by the (exchange) banks. We consider such a demand to be an extraordinary one. We believe that every respectable Indian customer of the Bank would be prepared to furnish the bank with full and reliable information about his financial position if his connection and dealings with the Bank justified such information being supplied. ... it may be regarded as a tall order from a Bank, advancing a casual loan asking the customer to disclose his fullest position to it. We disagree with the statement made by the experts that "secrecy about business affairs seems much more cherished in India than in other countries". The fact of the matter is that managers of non-national banks, not being either willing or able to keep in touch with their Indian customers ... rely for reports about the standing and financial position of their Indian customers on either their subordinates or third parties like brokers and hence the ultra conservative estimates of the credits deserved by Indian customers ..., we feel that such an extraordinary demand as that of having balance-sheets audited by approved auditors is, by itself, sufficient to make out a case for a change in the monopoly of the finance of India's foreign trade.—*Minute of Dissent to the Banking Committee Report*, pp. 383, 384.

however, find that the state of affairs is quite unsatisfactory from the point of view of business and trade of India The following are the grievances of the Indian traders against foreign exchange banks —

(1) The Indian importers are compelled to do business only on D P terms and they seldom get D A terms which is attributed to unsatisfactory bank references given by the exchange banks although the latter deny this fact

(2) In order to get a confirmed letter of credit opened, even first class Indian importing firms have to make a deposit of 10 to 15 per cent of the value of goods with the exchange banks, while European houses in Calcutta are not required to make such deposits

(3) Satisfactory bank references are not supplied by the exchange banks to overseas merchants, though in the case of foreign merchants with considerably lower resources, the banks of foreign countries supply very good references

(4) The Indian merchants have no opportunity of knowing under what rules the members of the Exchange Banks' Association work and that they are not consulted with regard to alterations made therein from time to time

(5) The exchange banks charge a penalty for the late completion of exchange contracts The penalty is high and is capable of reduction

(6) When a foreign exporter draws a bill on an Indian importer and the draft is with an exchange bank for collection, the Indian importer has to pay the bank in rupees at the bank's selling rate for demand drafts and he is not allowed to pay it either by the demand drafts of another exchange bank, which may be had at more favourable rates or by his own cheque on his London agent These banks do not accept demand drafts in payment, because they will not get in this way any commission for bill collection

(7) The exchange banks discriminate between Indian and foreign insurance companies and they are forcing Indian exporters to insure their goods with foreign insurance companies As a result of this attitude of the banks India has been paying annually insurance premiums to the extent of nearly Rs 2 to Rs 3 crores It is desirable that the Exchange Banks' Association should lay down standards to which the to Indians or companies should conform for obtaining the con- bills, in spite the exchange banks and the names of those Indian market could dian companies which conform to such standards rediscount tl is not, there published whose policies must be accepted by all creation of a anks without limit In this connection the majority to part with tal Banking Committee write that "the fact that no of Dissent, p 5 r incurred a loss on an Indian insurance policy we

trust that the establishment of more cordial relations between the exchange banks and Indian insurance companies may be speedily effected With this end in view we suggest that some understanding might be arrived at by the exchange banks in consultation with representatives of the Indian insurance companies similar to that between the Imperial Bank of India and these institutions "[8]

(8) At present when a draft comes to an Indian importer through an exchange bank, the former merely gets an informal note asking him to go to the bank and examine the documents although in the case of some European firms the facility of sending the documents to their offices is allowed The reason given by the exchange banks is that the party is not available until after six or seven rounds are made This may be true with regard to petty Indian merchants and dealers but " we doubt, however, whether it applies to big Indian merchants, for example, those in Clive Street, Calcutta, or in the Fort, Bombay '

(9) Although the exchange banks participate in the profits of our foreign trade yet they do not employ Indians and do not make any provision for their training ' We are impressed by the fact that though the exchange banks have been operating in India for more than half a century, they have not employed a single Indian in the superior grade of their service " It cannot be that these banks have not been able to find a single Indian competent to be entrusted with a superior post in their business

The majority of the Banking Committee say that " speaking from the point of view of trade alone, it may be said that the facilities available at present for financing India s foreign trade, both import and export, are sufficient Mr N R Sirker and his other colleagues in their separate *Minutes of Dissent* do not accept this contention and rightly point out that to have adequate resources is one thing and to utilize them impartially between Indian and European traders is quite another thing These banks do not utilize their vast resources in granting equal facilities to Indian traders and the low proportion of our share is due to the helpful advice and financial and other assistance granted to non-Indians, which however is not available to Indians to the same extent There is racial discrimination exercised by foreign exchange banks whose representatives themselves admitted before the Indian Banking Committee

[8] Mr N R Sarker suggests ' that the proper allocation of insurance business between Indian and non-Indian companies should be settled by a meeting of representatives of the banks and the Association of Indian Insurance Companies But if they cannot come to an agreement the Government will have to step in and arbitrate '—*Minute of Dissent*, p 562

that through social intercourse their European officials had more opportunities of obtaining intimate knowledge of the integrity and resources of foreign clients than that of Indians.

The extent of a nation's participation in foreign trade depends upon the facilities provided by the banking system Japan made special progress during the last 50 years in this respect because of the special assistance provided by the Yokohama Specie Bank established in 1880 The share of the nationals of the Japanese foreign trade increased from about one per cent in 1874 to 69 6 per cent of exports and 86 6 per cent of imports in 1922[9] The exchange banks finance our inland trade also on account of goods or produce in transit prior to export or immediately subsequent to imports and if they continue to finance this trade they will prove a menace to the development of national banking These banks are conducting their operations without a proper regard for our national interests and this has hindered the development of the monetary organization of the country They opposed the first Central Bank proposal of 1900 and in 1904 they again opposed the proposal to allow the Presidency Banks to borrow in London to relieve monetary stringency in India and this continued up to 1920 when the Imperial Bank Act was passed[10] 'These are in brief the problems confronting us namely, first that the Indian exporters and importers are seriously handicapped by the step motherly treatment of the foreign banks, secondly, that our general economic development is being jeopardised by their present mode of operations and thirdly that these are matters in which our nationals do not receive due encouragement The situation demands immediate intervention by the Government particularly as the foreign banks are now holding a predominant position in the banking world of India

Regulation of their Operations

(1) *Restrictions proposed*—The exchange banks should confine themselves to port towns and mainly to foreign trade finance They should not open any new branches in the interior This is necessary for the development of existing Indian banks and for the successful working of new ones The exchange banks will then utilize the services of Indian banks for their business in the interior which will strengthen the position of the latter Mr Sarker quotes in this connection the Proceedings of the International Conference on the Treatment of Foreigners held in Paris in 1929 and says that " In the course of the discussion it was accepted that the right of international

[9] *Present-Day Japan*, p 136 quoted by Mr Sarker
[10] *Minute of Dissent*, by Mr Sarker, p 357

commerce would not apply to the retail trade or hawking and peddling and that every nation could reserve to its own nationals these subsidiary trades

In this connection the practice of foreign exchange banks is also significant in other countries They are confined to the chief financial centres like Paris and Berlin or to the port towns as in Egypt, Australia, Brazil and Argentina The majority of the Central Banking Committee do not accept this suggestion on the ground that this will imply discrimination and that it will interfere with the facilities for Indian trade

(2) *Licensing of Foreign Banks*—Foreign exchange banks should be required to take out licenses for carrying on their business in India At present they are not subject to any legal restrictions in India and do not even publish their balance-sheets showing their Indian business separately from their other business Some control over them is necessary on broad national grounds to prevent them from exercising undue discrimination against Indian concerns Such provisions exist in the laws of foreign countries also In Japan the Finance Minister is authorized to impose restrictions on the issue of licences to foreign banks The majority of the Indian Banking Committee recommend in this connection that all non-Indian banks wishing to do banking business in India should be required to take out a licence from the Reserve Bank when it is established and that licences should be freely granted to the existing exchange banks. These banks should furnish to the Reserve Bank annual statements of their assets and liabilities and of their Indian and non-Indian business On the basis of reciprocity some further conditions might be included in the licence as is done by the Bank of England when it insists on two British signatures before rediscounting commercial paper There cannot, however, be any question of reciprocity between foreign and Indian banks Reciprocity should imply give and take principle but we are so heavily handicapped that we cannot take ' anything from others although we can give them as freely as we like It should also imply mutual influence which is not possible for India Reciprocity should imply mutual advantage but no advantage can accrue to any Indian bank in a foreign country in return for foreign banks being allowed uncontrolled domination in India If licences are freely granted to them, there will hardly be any use of those licences The licences should be for a fixed period and should contain some conditions which will make them really effective [11]

(3) *Restrictions on their Deposits*—Foreign banks in India get deposits at lower rates than are paid by Indian banks and compete with this money with national banks in India These restrictions will encourage joint-stock banks and indigenous

[11] *Minute of Dissent* by Mr Sarker p 360

banks in India as they will be able to get deposits for their business The majority of the Indian Banking Committee object to restrictions on deposits as it will interfere with the facilities for trade and with the freedom of Indian depositors and they further say that if the indigenous banks require to be protected against foreign exchange banks, it is because the former lack experience and adequate reserves and that both these things will take time to be acquired and that the pace cannot easily and safely be forced The majority also hold that there has practically been no change in the respective proportions of banking deposits of the Imperial Bank of India, the Indian joint stock banks and the exchange banks during the last ten years and that as compared with the pre-war year 1913, the share of the exchange banks has not increased appreciably If the tendency continues unchanged in future they do not think any necessity of restrictions on deposits of foreign banks They fear that such a course might initiate other countries in the matter of restrictions imposed by India on foreign exchange banks Mr Sarker in his *Minute of Dissent* does not accept this contention of the majority that the deposits raised in India by foreign banks have been stationary He shows that the deposits of Indian banks have come down from 70 63 crores in 1921 to 55 16 crores in 1928, while exchange banks have been able to maintain their deposits very nearly, the figures being 85 73 crores and 82 33 crores respectively He further points to the increase in the deposits of the Allahabad Bank from 9,35 lakhs in 1920 to 11 19 lakhs in 1928 as a sign of the movement of the funds which may become an inducement to other Indian banks in the future to get themselves amalgamated with the British banks [12]

He further points out to the unequal competition of the foreign banks with the indigenous institutions both in the port towns and in the up-country centres where the foreign banks have branches and points to the fact that the foreign banks together with the Allahabad Bank have been able to gather nearly 80 crores of deposits as against the same amount in the case of the Imperial Bank and 55 crores in that of the Indian banks He therefore says, Our problem is how to give the Indian banks a fair field for their development and extension by confining the foreign banks to their proper sphere in the port towns and the measures proposed should be designed to accomplish this purpose "

(4) *Registration of Exchange Banks with Rupee Capital*—Foreign banks should not be allowed to do business in India until they register themselves with rupee capital and have an Indian directorate The majority of the Indian Banking

[12] *Majority Report of the Central Banking Committee*, p 338 *Minute of Dissent*, by Mr Sarker, pp 554 555

Committee are against this proposal because the access to the London money market will be lessened, the rupee companies will have to pay a high amount for good-will and the depositors will not have the security of the existing international resources of the exchange banks. They observe, "The real intention behind the proposal seems to be to provide in the near future that a majority of shares in the new institution should be held by Indians. This is part of a larger question, namely, how far restrictions can be placed on the lawful trading activities of non-Indians in India. . . ." The Indian members in their *Minutes of Dissent* quote the cases of Spain, Roumania, Sweden, Norway, France, Italy, Japan and America in support of these restrictions and they also quote the recommendation of the Cunliffe Committee to the following effect :—"Several of our witnesses have called attention to the conditions under which it is open to foreign banks to establish themselves in this country. We suggest that this is a matter which should receive the early attention of His Majesty's Government."

(5) *Training and Employment of Indians*.—The exchange banks should provide facilities of training and employment for Indians for they get huge profits from their Indian business. The majority have recommended a scheme of probationary assistants on the model of the Imperial Bank of India's scheme. This does not go far enough. In Italy foreign banks can hardly appoint their own nationals as managers of local offices and in Turkey there is a provision that half the superior officers of foreign banks should be Turks. The International Conference on the Treatment of Foreigners also contemplated that one or two foreigners could be imported into a country as managers, etc., of foreign concerns. Some such scheme should be adopted for India and included in the terms of licence. The appointment of staff should not be regarded as a right of shareholders only. This question should not be left merely to the discretion of the foreign banks, but should be embodied in the terms of licences which should be revoked for failure of compliance of this condition.

It may be said that these suggestions may involve discrimination. So long as the intention is not to discriminate as such against foreigners, but to set right the banking machinery of India, "this cannot be called discrimination. If the indirect consequence is some discomfort to foreign interests then it must be regarded as unavoidable and inevitable in the process of making up for some of the evil effects of the policy pursued in the past."

The Scheme of an Indian Exchange Bank

The financing of foreign trade of India should not be left to be financed solely by foreign concerns. Germany, Japan and other countries took measures to increase the participation

of their banks in foreign trade It is not, therefore, desirable that India should rely for all time to come on the facilities provided by foreign exchange banks for financing our foreign trade The majority of the Indian Banking Committee have recommended that Indian joint-stock banks should first be encouraged to open foreign connections useful to their clients and this was what was done in Germany On the establishment of the Reserve Bank the Imperial Bank of India should be induced to take up the foreign exchange business subject to the following conditions —

(1) 75 per cent of the directors on the Local Boards and a majority of those on the Central Board of the Imperial Bank should be Indians and (2) the Imperial Bank should not make any further recruitment of non-Indians to its staff except in special cases with the consent and approval of the Finance Member of the Government of India

This device is open to many objections —Firstly the Imperial Bank is doing commercial banking business by providing banking facilities within the country and it is not desirable to divert it from this business even in part Secondly shares of the Bank are mostly held by non-Indians and even if the condition of 75 per cent directorate being Indians is accepted, a major portion of the profits would go outside India Thirdly, responsible positions in the Bank are occupied by non-Indians and even if further recruitment of non-Indians is stopped, it will be long before Indians will be able to replace them Just possible the Imperial Bank may not agree to the conditions laid down by the majority

If the attempts to secure for Indians their legitimate share of foreign trade finance in the above two ways are not successful, the majority of the Indian Banking Committee have recommended that a separate Indian Exchange Bank should be established after the Reserve Bank comes into existence with a capital of three crores of rupees in the first instance two crores to be raised in the first year and another one crore in the next two years [12] This capital could be increased when necessary The subscription should in the first instance be open to Indian joint stock banks, failing which the Government should purchase the capital or as much of it as is not taken up by the joint stock banks The Government should have a predominating voice so long as it holds more than 50 per cent of the capital and further details are to be framed in consultation with the Reserve Bank

---

[12] Thakur *Organization of Indian Banking* p 262 He proposes a capital of Rs 10 crores which he says might be reduced to even five crores if considered excessive Also see Annexure A by Mr Sarker *Indian Banking Committee Report*, p 571

Joint Banks

The majority have also recommended a scheme of 'Joint Banks' involving co-operation between foreign and Indian banks. Foreign trade implies two parties and it is necessary that no one party should have a dominant voice in determining the conditions of finance and trade. It is, therefore, suggested that joint-stock banks and foreign exchange banks should endeavour to find some method of amalgamation which would involve co-operation in place of cut-throat competition and would avoid the criticism that only one party was dominating in the matter. This matter is, of course, within the purview of the directors and shareholders and no compulsion can be introduced.[14]

It will be clear from the above that if the existing facilities do not bring an increased share of foreign trade into the hands of Indian banks, a foreign exchange bank—a purely Indian concern—is recommended to be brought into existence by the *Majority* after the Reserve Bank has come into existence.

In the *Minute of Dissent*, the signatories propose that the State should immediately start an exchange bank with a capital of three crores of rupees all to be taken up by the State. This bank should be allowed to finance foreign trade like any exchange bank now. All remittance business of the State should be done by the new Exchange Bank pending the establishment of the Reserve Bank. The staff appointed by the Bank should be Indian except that for a few years a non-national may be employed if the Finance Minister of the Government so advises. This bank can be checked from competing with Indian joint stock banks and it will be able to handle the enormous liabilities of the Government of India abroad which annually amount to 40 crores of rupees. With regard to the argument that foreign exchange banks may put up a tough competition against the Bank, the members say that this contingency operates with even greater force against the successful working of either the Imperial Bank or the Shareholders' Bank as proposed by the *Majority*. They recommend this step for foreign trade alone because in other fields of banking there are no powerful vested interests as in that of the finance of foreign trade which render delay in taking remedial measures equally

---

[14] With regard to this suggestion it must be remembered that foreign countries have their own banks in India and they will not enter into the scheme unless some form of compulsion is brought in because they will not have any additional advantage thereby. In fact it will mean their practical exclusion from India. Such a bank will require a very high amount of rupee capital and at least about Rs 2 crores will be required for each such bank from Indians. It is extremely improbable that even four such banks will be adequately financed by Indians with regard to their share.

detrimental to national interests They have therefore, recommended the establishment of the State Exchange Bank even prior to the establishment of the Reserve Bank

Export Credit Schemes

In other countries Government takes a very active part in providing facilities for merchants engaged in foreign trade In England there are private organizations like the British Trade Indemnity Company working for a long time and doing useful service in protecting exporters and bankers against the loss due to the failure of foreign importers in paying their debts Yet the Government have initiated a number of Credit Export Schemes themselves These agencies help the exporters in financing their shipments to those countries on which bills are not considered safe by private banks In Germany the Government is helping the private companies by re-insuring the whole of the 'catastrophic risk' In France the French National Bank for foreign trade was started by the Government for enabling the exporters to obtain advances against their shipments by drawing bills on the Bank to be discounted in the open market In Japan, the Japanese Exchange Banks enjoy special credit facilities with the Bank of Japan in connection with purchases of export bills Thus foreign banks have practically been excluded from Japanese export trade

The Government in India could create an Export Credit Board to guarantee the bills of Indian exporters on suitable security These bills would then be eagerly sought for by the exchange banks instead of being taken for collection as now and the Indian exporter would not have to wait for funds for a number of months This will also increase the participation of Indians in foreign trade to a very great extent

CHAPTER XII

Bill Market

It is generally accepted that from the point of view of a discount market bills in India are scarce The Royal Commission on Indian Currency and Finance dealing with the provision by which the currency authority in India is allowed by statute to issue currency notes up to a maximum of Rs 12 crores against internal bills of exchange, refer to the scarcity of such bills and write that "this provision has had beneficial effects in practice, but it is not in our opinion incapable of development and improvement in connection with a reorganization of the bases of Indian currency Any such provision depends for its proper operation on a plentiful supply of genuine trade bills But in India for a variety of reasons most of the internal trade is financed by a system of cash credits or by the advance of money against demand promissory notes It has, therefore, been found difficult to secure an adequate volume of bills as cover against the seasonal increase"[1] The Indian Banking Committee make the same complaint and they do not think that "this is due to a lack of knowledge on the part of people of the utility of this form of credit, or to an unwillingness to make use of it" Reference has been made by Dr L C Jain in his excellent work on Indigenous Banking in India to the use of Hundis as early as the 12th century A D[2]

The following table shows the investments of various banks in India for 1928[3]

	The Imperial Bank of India *Rs in Lakhs*	Six Indian Joint-Stock Banks *Rs in Lakhs*
LIABILITIES —		
Capital and Reserves	10,85	6,66
Current and Deposit Accounts	79,25	52,20
ASSETS —		
Investments	19,04	20,06
Bills	12,47	1,23
Advances	51,85	33,42
Cash	10,65	6,83

1 *Report of the Royal Commission on Indian Currency and Finance*, p 9, para 18

2 *Indigenous Banking in India*, by Dr L C Jain, p 10

3 *Report of the Indian Banking Committee*, p 408, para 591

The table shows that a very large portion of assets is locked up in investments It may be because banks in India have to maintain a relatively stronger liquid position than in Western countries or because the yield of the Government securities is more attractive than that of bills There are other reasons also for this state of affairs

(1) Banks usually do not discount their bills with the Imperial Bank of India because if they do so their credit is likely to be adversely affected Rediscounting is regarded as a sign of weakness by the market Besides, these bills cannot find a ready sale in the market so that they cannot be converted into money very readily

(2) Joint stock banks prefer loans on the security of Government paper to bills of exchange from the Imperial Bank The reason is that in some respects the Bank competes with other commercial banks and the latter will not like to give away the secrets of their bill portfolio to their rivals

(3) The system of cash credits is advantageous both to the banker and to the borrower The lending banker can withdraw credit if the financial position of the borrower deteriorates and the borrower has to pay interest only on the amount taken advantage of by him This system stands in the way of the development of the bill habit in India

(4) The Imperial Bank is prepared to discount bills approved by it, but it has not laid down any standards to guide the banks by which the latter can know whether a bill will come under the category of approved bills or not The joint-stock banks cannot, therefore, depend upon rediscounting facilities being extended to them and they do not, therefore, discount bills of higher amounts than their own resources allow them

(5) It is also suggested that the Imperial Bank charges the same rate for discounting bills from joint stock banks, *shroffs* and merchants If special facilities are allowed to joint-stock banks, questions of prestige will not stand in their way and they will take to rediscounting with the Imperial Bank

SUGGESTIONS FOR DEVELOPING THE BILL MARKET IN INDIA

(1) The Central Banking Committee recommend that when the Reserve Bank is established its published rate should be the minimum rate at which it is prepared to discount first class trade bills of member banks and the Bank should have full discretion

with regard to rates for open market operations. "To stimulate the use of bills the Reserve Bank should use its discretion to charge a higher rate for demand loans against authorized securities and it may find it useful to have a larger margin between these rates at the outset than will be necessary after the bill market has developed. Should the Reserve Bank find it necessary to discount the paper of the public without bank endorsement, it should consider whether it should not in the first few years at any rate charge a higher rate of discount to the public than that charged to member banks and bankers."

(2) Discounting charges are high at present and if they could be lowered, the use of bills would be facilitated. This happens when a person wants to discount a bill with a bank. The latter will charge a higher commission if the bill is payable at a place where the discounting banker has no branch and it will have to collect the bill through another banker. The banks in such cases should share the single commission between themselves equally in place of charging double commission. This can reduce discount rates.

(3) The Reserve Bank when it is established will be a bankers' bank and will not compete with commercial banks in ordinary commercial banking business and its position in relation to joint-stock banks will thus be different from their present position in relation to the Imperial Bank of India. This will dispel the present prejudice on the part of joint-stock banks against discounting their bills with the Imperial Bank of India.

(4) The establishment of warehouses or godowns in various parts of India would encourage the use of the bills because the finance bills would be replaced by documentary bills which would be more popular with banks.

(5) The stamp duty at present on bills is 18 pies per cent. which works out at 9 annas per cent. per annum as the bills are usually payable at 61 days. This is a very high rate which discourages a greater use of bills. The Royal Commission on Indian Currency and Finance had recommended the abolition of stamp duty on bills of exchange and this recommendation has been endorsed by the Indian Banking Committee. The latter Committee have further suggested that it should be given effect to

within a period of five years to enable the Local Governments to make good the loss of revenue They have also recommended that as an initial step the stamp duty on all bills of exchange of less than one year's usance should be reduced to two annas per one thousand rupees

(6) Printed bill forms should be made available in post offices both in English and the local vernacular

(7) Customs governing Hundis should be standardized in various provinces so that their circulation may be promoted If necessary, legislation may be resorted to in achieving the object

(8) The noting of dishonour and protest by recognized associations of bankers and *shroffs* should be validated to avoid trouble and expense to the owner of the instrument

The finance of agricultural industry can be promoted by the use of bills It can be divided into finance required for growing crops and that required after the crops have been gathered With regard to the latter it may be suggested that agriculturists may become members of co operative godown societies The latter may draw four months' bills upon the owners of produce and the societies can discount such bills with central co-operative banks and the latter in turn with other banks The owners of produce will get finance from the godown societies

A suitable form of agricultural paper will take a long time to develop to finance the growing crops The borrower may not grow the crop or natural calamities may destroy the crops if they are grown Thus there does not seem to be any immediate prospect of the development of agricultural paper to finance the growing crops

Indigenous bankers and co operative banks should co-operate to finance village bankers This can be done if indigenous bankers use commercial paper which is acceptable to the commercial banks Usance bills can thus be encouraged for the finance of village bankers by *shroffs* The absence of satisfactory documents of title will in the beginning prevent their use, but if the parties to the bills are worthy of credit, such bills will be discounted by banks in course of time

There will be a difficulty regarding the financing of cultivators by village bankers Bills with fixed dates of maturity will not be suitable in this connection because cultivators can pay these bills after selling their produce and the sale of crops will depend upon the season, while the maturity of the bills will be fixed Renewals of bills will thus be necessary but the process will be expensive and disliked by discounters In such cases dates of maturity may be fixed with reference to

CHAPTER XIII

Investment Habit

BANKING development depends very largely upon the growth of investment habit The latter in turn depends upon the wealth-producing capacity of the people of a country and upon their will and their power to save Wealth production in India is very meagre and the natural resources of the country are not properly utilized as to augment the national dividend The agriculturists who constitute the bulk of the population of India have little surplus even in normal times and those who have any savings prefer to invest them in land and gold and silver ornaments The fall in the price of silver has robbed the cultivators of India of a great deal of their savings because the value of their silver hoards has fallen tremendously Most of them have parted with their silver hoards to pay off the land revenue, rent and interest on money in the present depression as the real burden of these charges has increased immensely with the acute fall in prices, specially of agricultural commodities The few wealthy agriculturists who may have a surplus prefer to invest in land or jewellery to investing it in interest-bearing securities about which they know precious little The salaried middle class invest their savings in post office savings banks, postal cash certificates, etc The commercial community prefers to invest its surplus funds in treasury bills or short-term deposits Share capital and debentures are also purchased by people of this class and this was specially the case during the war period

Investment in land appeals to Muhammadans also because the Koranic injunctions forbid interest Appreciation in capital value is not regarded as interest and, therefore, real estate is the only means of investment for the orthodox section of the Muslim community

Next to land, jewellery is the most common type of investment for all classes of people in India This is a practice rooted in ancient custom and usage Hindu women are debarred from receiving any share of immovable property and, therefore, the giving of gold and silver ornaments to them as *Stridhan* at the time of marriage has become common Various economic and social causes in the past have influenced the investment of savings in the form of jewellery The lack of banking facilities in the early days, and the absence of suitable means of investment ensuring safety and easy realizability of savings have promoted this habit

With the introduction of the banking system and the spread of education, a reduction in expenditure on ornaments

and jewellery has been discernible The Punjab Banking Committee confirm this view when they write that "the immemorial custom of putting savings, and also a proportion of borrowings, into jewellery is beginning to weaken For the moment the change appears more marked than it really is, since much of it is due to trade and agricultural depression. But below this strong surface current may be clearly discerned an undercurrent flowing in the same direction and generated by deeper and more permanent forces Amongst the latter are education, the rising standard of living with its greater demand for money and wider facilities for investment "[1] It will thus be seen that the preference for jewellery is not permanent, but by means of education and sustained propaganda of banking habit, the prejudice in favour of jewellery can be removed gradually

The prevalence of hoarding habit is a great impediment in the way of the development of banking habit in India India has been called "the sink of precious metals" and this impression is very strong both outside and inside India 'Hoarding' is a term which is loosely used and no distinction is made by those who refer to it between the locking up of surpluses in gold or silver bullion or coin and the industrial use of precious metals The views of committees and commissions of experts do not confirm the view that hoards in India are unduly large The following extract from the Report of the Babington Smith Committee of 1919 may be quoted on the point —

"It has frequently been alleged that an undue proportion of the world's gold supply is absorbed by India It must be remembered, however, that the population of India exceeds 315 millions, and that the use of gold plays an important part in social ceremonies sanctioned by religion and tradition Presents of gold or silver ornaments are obligatory at weddings and on other ceremonial occasions and this custom is supported by the practical consideration that a woman, whether Hindu or Muslim, who possesses gold and silver ornaments, or coins converted into ornaments, is entitled to hold them as her personal property It has also always been the habit in India to use the precious metals as a store of value, and to hold savings in this form, nor, until banking and investment facilities have been extended, and the habit of using them has been acquired by the people of India, is it easy to see in what other form savings can be accumulated We do not, therefore, consider that the quantity of gold taken by India for all purposes in the period before the war was disproportionately large in relation to her economic conditions, and it must be assumed that so long as existing conditions prevail, India will

[1] *Punjab Banking Committee's Report,* para 226

continue to require a considerable quantity of gold for the purposes named above "[2]

The External Capital Committee of 1924 expressed a different view when they wrote that India possessed a large amount of potential capital which was locked up in gold and jewellery, and they were of opinion that as the net imports of gold and silver since 1913 amounted to 482 crores, it was enough to show that large resources were still being hoarded [3] The Royal Commission on Indian Currency and Finance also held the same view and said that India's demand for gold was not confined to monetary uses, but gold was largely used for purely social purposes Their recommendation for the introduction of savings certificates payable in gold was designed to attract "stores of wealth, great in aggregate, and at present lying wastefully inert, to their right function of meeting the needs of India for productive capital expenditure [4]

This question also came before the Gold Delegation of the Financial Committee of the League of Nations who in their interim report made the following reference to the question of the absorption of gold by India —

"From time immemorial, the population of India has purchased very considerable quantities of gold During the war years India was unable to satisfy her needs and she consequently effected exceptionally heavy purchases about 1924 In the last four or five years however, her demand has dropped back to between 80 and 90 million dollars per annum—a rate of consumption rather less than that of the last pre-war quinquennium We understand that attempts are being made to extend banking and investment habit in India, but we do not think it would be safe to anticipate any material reduction in the Indian demand for many years to come "[5]

The Finance Member in his Budget Statement which he presented before the Legislative Assembly in February 1933 remarked on the point as below —

"I wish to remind the House that even though the amounts exported have been very large, the figures are still small in relation to India's resources From September 1931 up to the end of December 1932 India had exported slightly over 11 million ounces of gold As compared with this the imports between April 1926 and September 1931 exceeded 15 million ounces so that in spite of the enormous

[2] *Report of the Babington Smith Committee*, para 61
[3] *Report of the External Capital Committee*, para 8
[4] *Report of the Royal Commission on Indian Currency and Finance*, 1926 paras 64 and 68
[5] *Interim Report of the Gold Delegation of the Financial Committee of the League of Nations*, pp 13 and 14

amounts hitherto exported, we are not yet back to where we were in April 1926 If we go further, the results are still more striking The net imports from April 1922 to March 1930 exceeded 28 million ounces, and this means that India can go on exporting gold until the total quantities have risen to three times the amount of what has already been exported and still have more gold in hand than she had eleven years ago "[6]

The view of the Indian Central Banking Committee on the point is as below —

"Having examined the question in the light of the information available to us, despite the absence of complete and reliable statistical information, we see no justification for the widespread belief that India has absorbed and still absorbs an undue proportion of the world's gold supply and that the accumulated treasure of centuries has been lying in hoards buried deep in the ground or hidden in the houses of the people In the days when life and property were not safe and when banking facilities were not available, hoarding was inevitable Social and economic conditions also influenced the predilection of the people for the precious metals Circumstances have, however, altered materially during recent years and there is little evidence of hoarding of precious metals in these days apart from the use of ornaments "[7]

The following table shows the value of imports and exports of gold to and from India for a number of years [8]

Value of Imports and Exports of gold coin and bullion for each quinquennium (average) from 1900–01 to 1921–25 and for each of the official years from 1925–26 to 1929–30
(Lakhs of Rupees)

	Imports	Exports	Net imports— or exports +
Average for 1900–01 to 1904–05	15,07	8,84	— 6,23
„ 1905–06 to 1909–10	17,50	5,75	—11,75
„ 1910–11 to 1914–15	29,92	4,58	—25,34
„ 1915–16 to 1919–20	19,65	6,23	—13,42
„ 1920–21 to 1924–25	36,45	7,74	—28,71
1925–26	35,23	38	—34,85
1926–27	19,50	10	—19,40
1927–28	18,13	3	—18,10
1928–29	21,22	2	—21,20
1929–30	14,23	1	—14,22

6 See the *Indian Budget Statement for* 1932–33 Also my article in *The India To morrow*, Wednesday, 21st June 1933 for further information and criticism
7 *The Report of the Indian Banking Committee*, p 437, para 638
8 *Report of the Controller of the Currency*, 1929–30, p 50

The table shows that since the year 1925–26 gold imports are declining and the yearly Report of the Controller of the Currency for 1929–30 shows that "the net private consumption of gold in India may be considered to have fallen from twenty-one crores in 1928–29 to sixteen and three-quarter crores in the year under report The low prices realized by India's crops naturally reduced the surplus available for the purchase of the precious metals and later in the year the heavy fall in the price of silver increased to a certain extent the demand for it instead of gold The low rates of exchange which prevailed throughout the year also made the price slightly dearer Apart, however, from these obvious factors, there does appear to be a steady decline in India's tendency to import gold for private use"[9]

Extension of Facilities for Investment

Though the fact of the existence of large hoards in India may be doubted, the necessity of developing deposit-banking in the country must be emphasized The remarks of the Indian Banking Committee in this connection deserve quotation They write, "We should like to emphasize the possibilities of developing deposit banking in this country The few existing branches of joint-stock banks and co operative institutions in the cities as well as in the mofussil have been successful in drawing out small savings of small people in urban as well as rural areas A good deal, however, yet remains to be accomplished The man in the remote interior has yet to be reached Slender savings of small men everywhere have yet to be garnered We have no doubt that if systematic propaganda for stimulating savings and cultivating the investment habit is carried on throughout the country and if the facilities for investment are extended, small men with savings would not be slow to respond Savings Associations founded on the lines of similar associations in Great Britain will undoubtedly be of great assistance in carrying out systematic propaganda for the development of the investment habit " (Paragraph 642 of the *Report*)

Suggestions for Promoting Thrift

(1) Post Office Savings Banks can promote thrift and investment habit to a much greater extent than has been the case so far Their principal object is to inculcate habits of thrift among the working classes and the lower and middle sections of the people in India Labourers and artisans and the peasantry specially, have not developed the habit of depositing their savings in the Post Offices

[9] *Report of the Controller of the Currency*, 1929–30, para 12

At present the limit of deposits and the total balance that can be held by a single depositor are Rs 750 and Rs 5,000 respectively The maximum balance that can be had to the accounts of minors is Rs 1,000 These limits can be raised to higher figures, say to 1,000, 10,000 and 2,000 respectively

(2) Post Office Savings Banks can open current accounts with or without interest and can allow depositors to withdraw money by cheques The Indian Banking Committee do not favour this proposal, but they suggest that " persons having savings accounts should be allowed to operate on these accounts, and to make deposits by means of cheques, the proceeds of cheques in the latter case being credited to the depositor's account on collection The system may be first introduced, as a tentative measure, in selected Post Offices and gradually extended as experience may justify Accounts may be allowed to be opened jointly in the names of two persons payable to either or survivor It would be a great convenience if the depositor were allowed to name a nominee to whom payment of the deposit should be made in the event of his death The present procedure necessitating an examination of the legal position of heirs entails delays " (Paragraph 646 of the *Report*) There does not seem to be any reason why Post Offices should not open current accounts and allow withdrawals by cheques provided cheque forms are available printed in local vernaculars The services of clerks having experience in banks may be availed of or the Imperial Bank may depute its own men on payment to work in the Post Offices and this experiment may be tried in selected Post Offices and extended if it is found to work satisfactorily

(3) Postal Cash Certificates can form another medium of the development of investment habit They have drawn out a considerable amount of savings of small people to whom they have proved attractive Their popularity could be increased if a holder of them were allowed to nominate a recipient in case of death The maximum investment in them cannot exceed Rs 10,000 at present in the case of a person and this limit can be considerably raised to advantage The provident fund of a large number of employees is deposited in Post Offices in the name of the employers and the limit of Rs 10,000 forbids any larger portion being invested in cash certificates If an exception could be made in such cases, it would be of great advantage to employees Some people suggest the abolition of these certificates The yield on them is higher than on deposits in banks and, therefore, they compete with banks This view does not seem to be sound

(4) *Savings Certificates payable in gold*—The Royal Commission on Indian Currency and Finance in 1926 recommended the issue of " 'on tap' savings certificates, redeemable

in three or five years, in legal tender money or gold at the option of the holder. They might be issued in denominations of one tola and integral number of tolas, and sold for legal tender money, rupees and notes, at a price which would give the holder an attractive yield in interest. It would add to the attractiveness of the certificates if the holder were given facilities to obtain payment therefor at any time during their currency at a discount reckoned at varying rates according to the date of encashment, but until the date of maturity, it would be paid in legal tender currency and not in gold.

The offer of such certificates should constitute a powerful incentive to investment and a powerful antidote to hoarding. When this certificate matures, the holder of the maturing certificate will receive a striking demonstration of the advantages of investment and of the solidity of the gold basis of the rupee. It is legitimate to hope that the certificates will greatly assist in an ultimate solution of the problem of India's hoards."[10] The Indian Banking Committee support these proposals but they doubt whether it would be feasible to give effect to them under present conditions (Paragraph 619 of their *Report*.)

(5) Money can be invested in Government securities also. A person can invest through the Post Office in any loan issued by the Government of India bearing interest at 3½ per cent or upwards. The total amount after deducting any sum sold through the Post Office which may be invested through the Post Office by an individual in a year from the 1st April to the 31st March is Rs. 5,000. The Post Office also sells at the current rate, and free of expenses the whole or any portion of any Government promissory notes which may have been purchased for him through the Post Office, whether held by himself or by the Deputy Accountant General, Posts and Telegraphs for him, provided that the investor is also a Savings Bank depositor at the time of application and also that if only a portion is specified for sale the balance of securities left after sale is of the nominal value of Rs. 100 or a multiple of Rs. 100. No fee, commission or brokerage is charged for the sale, purchase or safe custody or delivery of Government securities bought through the Post Office or for realizing or remitting interest on them. The interest on them is free from income tax so long as the securities purchased through the Post Office remain in the custody of the Deputy Accountant General, Posts and Telegraphs. If such facilities are extended to all small investors whether they are savings bank depositors or not, it will attract a large amount of dormant capital.

---

[10] *Report of the Royal Commission on Indian Currency and Finance*, paras. 67 and 68.

Banks also can popularise the gilt-edged securities to a greater extent than they do now by reducing their charges for the purchase and sale of scrips, collection of interest, safe custody, etc. They can also offer easy terms for the purchase of securities in instalments as is done by the Imperial Bank of India to promote new floatations.

(6) Investment in industrial securities is made by a wide circle of people. All over the world there are people who are not satisfied with a low yield and are prepared to take risks by investing money in share capital and debentures of concerns which offer the prospect of a higher yield than that of gilt-edged securities and in which the value of capital can also appreciate. In normal times no difficulty is experienced in finding out capital for joint-stock concerns in India provided there are good prospects for the concerns, but there is no regular investment market in the country. Investment banking institutions which can investigate into the possibilities of industrial concerns do not exist here. The facilities of underwriting shares and of marketing industrial securities are not very good in this country. The promotion of such institutions will help in floating sound concerns and in marketing their securities and will also inspire public confidence in such forms of investment. There are stock exchange markets in Bombay, Calcutta and Madras which direct the flow of capital to industrial enterprises by providing a market for the purchase and sale of recognized scrips. They do not exist in other provinces.

(7) Insurance companies in every country are a good means of promoting thrift and saving and also of directing the investment of capital into industries. In India, such concerns are non-Indian, and the question of investment of their funds is one of peculiar interest from the point of view of developing the banking resources of the country. A large portion of their income is invested outside India and they should be compelled by legislation to invest a fixed portion of their premia in approved Indian securities and to place an initial deposit with Government. The Central Banking Committee recommend, "We consider it essential for the economic development of the country that all insurance companies doing business in it, whether Indian or non-Indian, should, by a judicious investment of their funds, assist in the promotion of public utility undertakings and the finance of the trade and industry of the country generally. We, therefore, recommend that legislation may be undertaken to render it obligatory on all insurance companies, Indian as well as non-Indian, to lodge an initial deposit with Government and to invest, and keep invested, a fixed proportion of their premia funds in approved Indian securities." (Page 445 of the *Report*.)

(8) Many private and public employers have started

provident fund benefits for their employees which are as necessary as insurance companies. All possible encouragement should be given to promote savings from this source.

(9) The cheque habit should be promoted among people in India. The abolition of the stamp duty on cheques since August 1927 which was done in response to the recommendations of the Hilton Young Commission has been responsible for the growth of the cheque habit in the country. The Indian Banking Committee write in this connection, 'Evidence is forthcoming from all directions of a substantial increase in the number of cheques which daily pass through the Clearing Houses. The recent abolition of the stamp duty on cheques appears to have contributed materially to a more extensive use of the cheque not only in the Presidency towns and other big commercial centres but also in the mofussil. The co-operative banks also recorded a rise in the number of new accounts opened and the cheques issued by them. There is, however, still a large portion of the population to whom the cheque system is a mystery. It has yet to understand and appreciate the facility and the security a cheque currency affords both to the drawer and the payee." (Paragraph 663 of the *Report*.)

The illiteracy of the people stands in the way of the development of the cheque habit. The cheque system necessitates an elementary education and a knowledge of reading and writing. A single erasure on the cheque form vitiates the cheque and as cheque forms are printed and are required to be written in the English language stands in the way of any wide adoption of the cheque habit. It is, therefore, very necessary that cheque forms should be printed in local vernaculars also side by side with English. Other recommendations of the Central Banking Committee to promote the use of the cheque system in the country may be quoted *in extenso*. They write, "Government can assist materially in spreading the cheque system in rural areas by accepting freely payment of land revenue by cheque. Such payments are now, under certain conditions, accepted at treasuries which are managed by the branches of the Imperial Bank of India. Very few people are, however, in a position to avail themselves of this facility. The number of such branches is limited and they are situated mostly at district headquarters. It is, therefore, suggested that the facilities for payment of land revenue by cheque may be extended to *taluqa* sub-treasuries and district treasuries. We support this suggestion. It is also suggested that all material payments should be made by Government by cheque." (Paragraph 665 of the *Report*.)

Local bodies can similarly encourage the use of cheques

The Indian Banking Committee "recommend that all municipalities and other local bodies should be asked to consider the feasibility of making and accepting payment by cheque on account of salaries to some of their employees and other items of receipts and disbursements."

Banks can encourage the use of cheques by giving adequate facilities for prompt encashment over the counter. Merchants and businessmen should also as far as possible use cheques in place of currency notes and rupees in the settlement of transactions and in moving crops in the country. If the cheque habit widely develops in these markets, banking habit will increase to a great extent with small traders. The circulation of cheques in the money market and the mobility of the banking resources of the country depend largely on the facilities provided by banks for transfer of funds from place to place.

(10) Savings associations ought to be started in India to stimulate thrift and savings among the people. Such associations were started in England during the war to promote the issue of war loans and their activities have been continued in the post-war period on account of their success. There is now a National Savings Committee in England, guiding a large number of National Savings Associations in the country. These latter associations have been formed to help their members to invest in the National Savings Certificates. Such organizations, if widely scattered in a country, have important educative effects and render immense service to the development of banking. They encourage small savings by active propaganda and by providing means for the collection of such savings and by getting them invested in good securities. The formation of such associations should be encouraged in this country.

CHAPTER XIV

Regulation of Banking.

BANKING institutions are entrusted with the cash resources of the people and therefore they exercise a very powerful influence upon their economic life Banking business is of a quasi public nature and the interests of depositors upon whose confidence the growth of banking depends, must be protected by legislation In some form or other restrictions are imposed upon banking business in all countries according to their requirements Some countries like the U S A and Canada have special banking laws, whereas others like England and India regulate their banking business by Company Law In England matters not covered by the Company Law are governed by tradition and convention which have grown up in course of time

POSITION IN INDIA

In India banking business is governed by Company Law Various matters connected with the promotion, audit balance sheet, winding up etc of banks are regulated by the Indian Companies Act In certain respects, the Act differentiates between banking corporations and non banking concerns and some of its provisions apply specially to banks

Section 4 of the Companies Act provides that if the number of partners in a partnership business exceeds ten, they cannot carry on banking business without being registered as a company Section 32 requires the preparation of an annual list of members and its filing with the Registrar and Form E requires banking companies to show a list of all their places of banking business Section 132 provides that the balance-sheet of a bank should conform to Form F as nearly as possible and with regard to book debts, secured and unsecured debts have to be shown separately and the banks need not show the provision they make for bad and doubtful debts According to Section 136 a limited banking company has to make a statement in Form G in the Third Schedule before commencing business and thereafter half-yearly The Government is empowered by Section 138 to appoint inspectors to examine the affairs of a banking company in case members holding not less than one fifth of the shares issued apply for it The provision in this respect for other concerns is different According to Section 145 the auditor should have access to the books of branches outside India of banking concerns and it is sufficient if access is allowed to extracts from books sent by the branch to the head office Section 259 requires a banking company

which was in existence on May 1, 1882, to inform account holders of its intention to register as a limited company at least 30 days before registration

There is a good deal of truth in the statement that the Indian Companies Act touches only the fringe of the problem of banking legislation and there should be some legislative control over the operations of those banking concerns which do not come under the Indian Companies Act In 1913 the Government of India consulted the Local Governments on the point It was not intended to regulate industrial banking but to regulate only such concerns as partnerships and individuals which were carrying on banking business on unsound lines The replies received were in favour of legislation requiring that institutions calling themselves "banks" should be registered under the Indian Companies Act and that they should confine themselves to banking business only

Commenting on the need for a special Bank Act for India, the Indian Central Banking Committee write, "We are not in favour of elaborate banking regulations and restrictions dealing with matters which had best be left to the discretion and sense of responsibility of the directorate and the management, such restriction is at times likely to do more harm than good and to hamper the activities of banks At the same time, we are of opinion that the existing provisions in the Indian Companies Act governing banking companies are inadequate Several important matters having a vital bearing on questions such as the initial organization of banks, their efficient management and stability, provisions for supervision and examination and publication of accounts, the safety of shareholders and depositors and the development of banking generally on sound lines remain to be provided for We do not suggest that it is necessary to provide for all these matters by legislation Some can be met by suitable provisions in the Memorandum and Articles of Association of the different banking companies according to their respective requirements, subject to the approval of the Registrar of Joint-Stock Companies, some might be left to the control of directors and the supervision of auditors, while some would be within the purview of the Reserve Bank when it is established Nevertheless, there will remain certain matters which, in our opinion, will have to be provided for by legislation "[1]

The existing regulations can be amplified in two ways firstly, by a special Bank Act and secondly, by amending the Indian Companies Act in a suitable manner and clearly the former alternative is more desirable This view has been taken by the Indian Banking Committee also

[1] *Report of the Indian Central Banking Committee*, pp 450 and 451, para 671

supply a means of ready reference and prompt decision, open to the bank clerk and public alike "[2]

The Royal Commission on Indian Currency and Finance, 1926, suggested that "the term 'bank' or 'bankers' should be interpreted as meaning every person, firm or company using in its description or title 'bank' or 'banker' or 'banking', and every company accepting deposits of money subject to withdrawal by cheque, draft or order "[3]

The Commission did not think that indigenous banking should be covered under banking regulation without further consideration of the subject "What is really needed is a register of bankers without a hard and fast definition and we are of opinion that the situation in India as regards indigenous bankers will best be met by an arrangement for the enrolment of such bankers as members of a recognized association " (*Report of the Indian Banking Committee*, page 155, paragraph 681)

A Bankers' Association should be formed and the members of that association may add to their name the appellation "Member of the Bankers' Association" which will give recognition to the members as bankers

Licensing of Banks

It was suggested before the Indian Banking Committee that all concerns carrying on banking business except Indian joint-stock banks and co-operative banks should take out a licence which would impose certain obligations on their working The Indian Banking Committee do not favour this suggestion as it would be unfair to the indigenous bankers who now supply a good deal of finance in India They recommend that banks, Indian or foreign, wishing to do banking business in India should be required to take out a licence from the Reserve Bank when it is established This will give the Bank some control over the banks in India Licences should be freely granted to the existing bankers in India and it would be the duty of the Reserve Bank to see that the terms of licence are complied with

The object of the proposal "is to ensure a systematic development and extension of joint-stock banking and not to impede in any way free competition Having regard to the present stage of literacy of the people, we consider it essential that a bank should be organized on certain recognized principles of banking and that no institution calling itself a bank should start operations without obtaining a licence from the

---

[2] '*Law of Banking*', by Sir John Paget, quoted by the Indian Banking Committee on pp 453 and 454 of their *Report*

[3] *Report of the Royal Commission on Indian Currency and Finance*, 1926, para 162

Reserve Bank Having regard also to the present stage of development of banking in the country, we consider it essential that there should be a policy of encouraging expansion of banking in areas where there is need for it and discourage the multiplication of banking institutions beyond the needs of business in particular localities We have no doubt that the Reserve Bank would be willing to encourage the expansion of banking as much as possible and that its policy in granting licences would be influenced solely by the considerations of the economic interests of the country (*Report of the Indian Banking Committee*, paragraph 685) The opening of a new branch by an existing bank should be subject to the permission of the Reserve Bank

The Act should further provide that any institution operating in India, barring foreign banks, should have a majority of directors who are Indians This is necessary to prevent the control and management of a service of national importance as banking passing into the hands of foreigners It would not be possible to follow a policy in the interests of India unless non-nationals are prevented from having a preponderating voice in the management of banks in India No new bank other than a foreign bank should operate in India unless the majority of its shareholders are Indians [4]

The combination of banking business with other activities should be prohibited because banking and trading cannot go on side by side successfully Many banking institutions failed in the past in India because they combined trading operations also with their banking activities and the case of the Alliance Bank of Simla can be cited on the point

The Bank Act should specifically prohibit the organization of a bank on the managing agency system and subsequent arrangements for conducting the management of banks according to the system should be made null and void

The Act should prescribe a minimum amount of capital for a banking company without which it should not be able to commence operations There should also be some definite relationship between the authorized and subscribed capital

---

[4] Paragraphs 689 and 690 of the *Indian Banking Committee's Report* Some of the members of the Indian Banking Committee did not agree with this view and held that no restrictions should be laid down by law on the rights of shareholders to choose their own directors and on the transference of shares and that these matters may be provided for in the Articles of Association In this connection it may be said that if provision of these matters in the Articles of Association is compulsory the effect is the same as if the provision were made by law If it is not compulsory, Indian interests will not be served by lack of provisions in the Articles if no provision is made there Legislative provision is, therefore, better than provision in the Articles of Association

and between the subscribed and paid-up capital In this connection a very high minimum should not be fixed which may prevent the formation and growth of small banks in areas which are not served by banks at present In the existing stage of development of banking in the country a minimum capital of Rs 50,000 should be sufficient A new bank should not be registered under the Act unless it has a paid-up capital of Rs 50,000 The authorized capital of a bank should not be more than double the subscribed capital and the paid-up capital should be at least 50 per cent of the subscribed capital before commencement of business At present the Indian Companies Act does not make provision in these respects and the result is that concerns can start with a very high authorized capital to mislead the public with regard to their resources and paid-up capital is usually very small In 1927, "six out of the sixteen banks that failed or went into liquidation had practically no paid-up capital" These provisions of minimum capital should apply to concerns with limited liability only

Register of Members

The Indian Companies Act provides that a register of members should be maintained and an annual list of members prepared The new Act should provide for the maintenance of a separate index of the names of members of a banking company to facilitate ready reference and inspection by shareholders as is done under the English Companies Act

The new Act should also provide that banks doing their business in India should keep a separate register of shares owned by non-nationals

Registration of Transfer of Shares

According to the Articles of Association, directors can generally refuse to register the transfer of shares without giving any reason Some witnesses suggested before the Indian Banking Committee that this power should be denied to the directors in case of fully paid-up shares or that they should be compelled to assign reasons for their refusal The Indian Banking Committee do not wish to restrict the discretion of the Board of Directors, but suggest that this provision can be inserted in the Articles of Association if the promoters or shareholders think it necessary to restrict the powers of directors with regard to registration of transfer of shares (Paragraph 699 of the *Report*)

The Articles of Association of banking companies prohibit a member from being present at a meeting to exercise the power of voting unless he has been in possession of shares for a certain period of time before the meeting Some people think that the period should not exceed six weeks and that

the directors should be prevented from unduly putting off registration of transfers to bring a shareholder within the purview of the clause The Indian Banking Committee in this connection write, "We are of opinion that it is for the company to provide in the Articles of Association the period during which a member should have held its shares before being entitled to take part in its proceedings In order, however, to prevent unnecessary delay in the registration of transfers, we recommend that there should be a provision in the Bank Act requiring the directors to decide within two months of the date of presentation of transfer deeds to the bank whether the transfer shall be registered or not " (Paragraph 700 of the *Indian Banking Committee's Report*)

Registration of Mortgages and Charges

According to Section 109 of the Indian Companies Act particulars of charges and mortgages created by a bank on its own assets have to be registered with the Registrar Such documents should also be registered with the Registrar of the province where the bank has branches to enable people who deal with the branches to have a better means of ascertaining the nature of such transactions which affect the credit of the bank and this suggestion has been endorsed by the Indian Banking Committee in Paragraph 701 of their *Report*

If a bank acquires assets subject to a prior charge and if those assets are such that a mortgage on them would have been required to be registered according to Section 109 with the Registrar in case such property were owned by the bank, the bank should get the particulars of such prior charge registered It makes no difference whether the bank itself creates such a charge or acquires assets subject to a prior charge This provision should be introduced in the Bank Act The recording of the satisfaction of a mortgage before the Registrar under the present law is not compulsory This should be made compulsory

(2) MANAGEMENT

Provision of Reserves

The soundness, stability and reputation of a bank depend upon the allocation of a portion of its profits to the building up of strong reserve funds which may be utilized in times of need In various countries, banks are compelled by law to allocate a certain portion of their profits to reserves before distribution of dividends to shareholders In America under the National Bank Act every bank has to allocate 10 per cent of its net profits to reserve until the latter reaches 20 per cent of the capital The Bank Act of Canada lays down that the rate of dividend cannot exceed 8 per cent per annum until

the reserve fund is equal to at least 30 per cent. of the paid-up capital. In Japan the Act of 1927 provides that no dividends can be declared until one-tenth of the profits is appropriated to reserve fund. In India also something should be done in this connection. The Indian Banking Committee write, "We cannot too strongly emphasize the fact that the first essential of a banking system is sound management and that if that is wanting, no legislative provision for strengthening its reserves or its financial position generally would be of much avail. In view, however, of the fact that banking in this country is yet in its infancy we recommend that there should be no distribution of dividend in any year until a bank has set aside, for being taken to the reserve fund, an amount equal to at least 2½ per cent. of its paid up capital and that this restriction should be in operation until the reserve fund equals the paid up capital." (Page 163, paragraph 704 of the *Report*.)

There is also a very great necessity for the formation of secret reserves which can be utilized to meet unforeseen losses without touching the reserve fund disclosed in the balance-sheet. The minimum prescribed by law is regarded as the maximum for safety by banks and that is the reason "why the legislature generally shrinks from regularizing by law matters such as these, thereby taking off the shoulders of the management their responsibility in regard thereto." Considerations of sound management require that managers of banks should not remain satisfied with the allocation of the minimum amount provided by law to be carried to the reserve fund. They should add to the reserve fund adequate amount after reviewing the position from year to year.

Position regarding Cash Reserves

Cash reserves of an adequate amount should be kept by banks to ensure solvency and to prevent a run on them by the depositors. Demand liabilities must be promptly met, otherwise solvency might be endangered. America is the only country where minimum reserve requirements for commercial banks have been laid down by legislation. Statutory provision on the matter is not necessary because the statutory minimum may be regarded as the maximum by the authorities of the banks and legal requirements can also be evaded in many ways. The question of inter-relation of reserves, deposits and loans and the maintenance of adequate fluid resources to meet the day-to-day requirements and to meet time liabilities are matters which have got to be left to the discretion of the directors of banking institutions. On the establishment of the Reserve Bank, the member banks will be required to keep a deposit of a certain percentage of their time and demand liabilities with the Bank in addition to their till money. This will be a very great improvement

on the existing position regarding the maintenance of cash reserves and it will also give the necessary mobility to the cash resources of various banks

Regulation of Loans

Prudent banking requires a sound policy regarding loans Many suggestions can be made to achieve this object The total clean advances made by a bank or advances against immovable property should not exceed its paid up capital There should be a limit to the advances granted to an individual without security More than a certain amount should not be lent to an individual or a business concern and the limit should be absolute This is to ensure a wide distribution of risks These matters cannot, of course be subjected to hard and fast rules and should therefore be "left to the discretion of the management and the control of the Board of Directors "

Loans should not be made on the security of its own stock by a bank Such loans can lead to abuses which have proved disastrous in India and other countries as well No bank should be allowed to commence business until it has collected a certain amount of capital The Articles of Association should prohibit the granting of loans by a bank on its own stock Loans to directors, managers and members of the staff of a bank should also be similarly limited and provisions to this effect should be made in the Articles of Association

Advances to auditors or to firms of auditors which audit the accounts of a bank should not be granted by the bank The Indian Banking Committee are very emphatic on this point when they write, "We are therefore, of opinion that as a matter of public policy advances to an auditor or a member of a firm of auditors of a bank, either jointly with other persons or severally, on short or long term, with or without security, should be prohibited If any person after being appointed an auditor of a bank becomes indebted to it his office should thereupon become vacant " (Paragraph 711 of the *Report*)

Restrictions on Borrowing Powers

The directors should not be allowed to borrow unlimited amounts on behalf of the banks and there should be some relationship between the paid-up capital and borrowings of banks Provision to this effect must be made in the Articles of Association but there should be a statutory provision prohibiting the mortgaging of the uncalled capital of a bank as it is the security of a bank's creditors

The directors and other paid servants of banks who are also shareholders in the banking concerns should not be allowed to hold proxies for the purpose of voting on behalf of any other shareholder, but their own rights as shareholders

should not be taken away from them Articles of Association should make suitable *provisions on the point*

Individual shareholders should not be allowed to have a very large number of votes as to acquire a very great control of the concern into their hands The Indian Banking Committee recommend that the matter should be left to be incorporated in the Articles of Association, but there does not seem to be any reason why it should not be provided for by law

The chairman is usually the sole judge of the validity of the votes tendered at the poll and the Articles usually provide that objections to the validity of the votes tendered at a meeting should be raised at the time of the poll This is rather a hardship because shareholders may not come to know the invalidity of votes tendered at the time of the poll and, therefore, the Articles should provide that objections can be raised later on also

Audit and Inspection

According to Section 141 of the Indian Companies Act, no person can be appointed as an auditor of a company other than a private company unless he holds a certificate from the local Government empowering him to act as an auditor The Governor-General in Council can, by a notification in the *Gazette of India*, declare that members of an institute or association shall be entitled to be appointed and to act as auditors The appointment of auditors rests with the shareholders, but the management has considerable influence with regard to their appointment or reappointment The Indian Banking Committee have not recommended any change because the powers of shareholders under the present law are unfettered They recommend that 'there should be a specific provision of the law rendering officers or auditors of a bank liable for omission to state material facts in their reports and in the presentation of the accounts of a bank" Section 282 of the Indian Companies Act makes an auditor liable to fine and punishment for making deliberately false statements in the reports It is the usual practice that the Articles relieve directors and auditors from liability for negligence in the discharge of their duties

The shareholders should have full discretion over the payment made to the auditors by way of remuneration or by way of any addition to their remuneration for doing accountancy work, etc

According to Section 138 of the Indian Companies Act shareholders of a bank holding one-fifth of the shares issued can apply to the local Government for investigation by inspectors The proportion may be reduced to one-tenth as

it is very high, but the Indian Banking Committee are not in favour of any change in this respect, because credit institutions should be protected against any proceedings which may shake the confidence of the public

Balance-sheets of banks should give more information than is the case at present Form F of the balance-sheet prescribed by the Indian Companies Act is not considered comprehensive enough Even those who understand accounts cannot gauge the actual position of the assets and liabilities of a bank in many cases People, therefore, hesitate to rely upon balance sheets of banking institutions More detailed information should be given regarding book-debts, loans to directors and officers and investments

Loans granted by a bank to a limited company whose directors are also the directors of the lending bank should be shown separately Further, loans granted to a limited company in which any of the directors of the lending bank are members of the firm of managing agents of the borrowing company should also be shown separately Loans granted by a bank to its directors, manager and secretary including the sums repaid by them during the currency of a financial year should be separately stated in the balance-sheet and should not be shown in one heading only

At present banks are not required to show their investments at either cost or market value and the result is that investments are shown in some cases at a valuation which may be neither the cost nor the market value The foreign experts who collaborated with the Indian Banking Committee were of opinion that the valuation should be at cost or market price whichever is the lower If this suggestion were accepted banks could not build up secret reserves because they will be prevented from showing the valuation at a figure even lower than the cost or market price The Indian Banking Committee in this connection write, "We are, therefore of opinion that in order not to take away such option from them, the prescribed basis of valuation of securities should be that the valuation should not be in excess of cost or market price whichever is the lower" (Paragraph 729 of the *Report*)

The following is the form of balance-sheet which may be adopted in place of the existing one[5] —

[5] *Report of the Central Banking Committee*, pages 474, 475

FORM OF

BALANCE SHEET AS AT

CAPITAL AND LIABILITIES	Rs A P	Rs A P
CAPITAL—		
Authorized Capital shares of Rs each		
Issued Capital shares of Rs each		
Subscribed Capital shares of Rs each		
Amount called up at Rs per share		
Less—Calls unpaid		
Add—Forfeited shares (amount paid-up)		
LOANS ON MORTGAGE OR MORTGAGE DEBENTURE BONDS		
RESERVE		
(Details of separate funds, if any, may be given)		
LIABILITIES—		
Current and Savings Bank Deposits		
Fixed Deposits		
Debts due to Banks, Agents, etc , fully secured against securities *per contra*		
Debts due to Banks, Agents, etc , unsecured		
Bills Payable		
Sundry Creditors		
Unclaimed Dividends		
ACCEPTANCES FOR CUSTOMERS *per contra*		
BILLS FOR COLLECTION BEING BILLS RECEIVABLE *per contra*		
PROFIT AND LOSS—		
Balance as per previous Balance Sheet		
Less—Appropriation thereof		
Balance brought forward		
Profit since last Balance sheet		

CHAPTER XV

Law and Practice of Negotiable Instruments

CHEQUES, bills of exchange, promissory notes and *Hundis* may be called negotiable instruments which are used in business In India cheques and *Hundis* are used in facilitating the settlement of transactions These documents possess certain characteristics which entitle them to be called negotiable instruments

A negotiable instrument possesses two characteristics firstly, rights in it are transferred from the transferor to the transferee by endorsement and delivery or by delivery alone Secondly, in some cases the transferee can get a better title than that of the transferor When the transferee is a "holder in due course", his title is perfectly safe even though the title of the transferor may be defective and he can sue the drawee for payment in his own name Any instrument which possesses these two characteristics is called a negotiable instrument These instruments are, therefore, called negotiable instruments If A has a cheque with him and owes some money to B, he can discharge his debt by handing over that cheque to B This means that the right of A in the cheque to demand payment from the drawee is passed on to B to whom the cheque has been transferred, but it is the exact right of A that is transferred and B's title cannot be said to be better than that of A But B is a holder in due course when he obtains a bill or an instrument for value, complete and regular on the face of it, on or before the due date of payment and without knowledge of the defect in the title of the transferor if the transferor's title is actually defective If A has stolen a bill of exchange and passed it on to B for which B has paid an adequate value to A and there is no irregularity on its face, *i e*, payee's name, etc, is not erased, B can be a holder in due course Further, B must not know that A stole that bill of exchange, for if he knows this fact, he cannot get a better title than that of A Therefore, even if the title of the transferor is defective, the transferee, in order to be a holder in due course, must be absolutely innocent of the defect in the title of the transferor, otherwise he will not be a holder in due course This applies to the defect in the title of the immediate previous transferor only If there is a defect in the title of any transferor previous to the immediate transferor, the title of the transferee is not affected thereby unless the transferee was himself a party to the fraud A transfers a bill of exchange to B which he had stolen and B is an innocent party B

transfers it to C who is aware of the defect in the title of A, then C will be a holder in due course unless he was a party to the fraud committed by A. A holder must not only be honest but must act with due diligence and caution, i.e. if he takes up a bill wanting in any material particular, he cannot acquire a good title to it.

The privilege of a holder in due course is that his title to the instrument is perfectly good and he is entitled to get payment in his own name even if some other person is claiming such a right of getting the payment of the instrument.

CHEQUES

When a person opens a current account with a bank, he has to sign his name in an autograph book of the bank and is supplied with a cheque book, free of charge, containing a number of cheques varying from about 20 to 100. Money is drawn from the bank through a cheque. It may be quite in order to write an order on a piece of paper to the banker asking him to pay the money to a certain person, but to maintain uniformity and security against fraud, banks make payments only through cheques.

SPECIMEN OF CHEQUE

No 2A 68507	No 2A 68507
Dated 15*th Nov*, 1933	*The* 15*th November*, 1933
In favour of	IMPERIAL BANK OF INDIA, CAWNPORE BRANCH
Mr Ram Kumar	*Pay to Mr* RAM KUMAR *or order* *Rupees Two hundred and fifty only*
Rs 250–0–0	
SRI KRISHNA	Rs 250–0–0 SRI KRISHNA

The above is the specimen of a cheque. The right hand oblong portion is the cheque form which is filled in by the drawer, the customer of the bank. It is torn off at the perforated end and handed over to the creditor or the payee in whose favour it is drawn. The drawer must sign his name at the right hand bottom corner in the same style and spellings with which he has signed in the autograph book of the bank. If the signatures of the drawer on the cheque form do not agree with those in the autograph book in spellings or style, the banker will not pay the cheque.

The left hand portion is called counterfoil and remains in the cheque book. It contains all the information with regard to a cheque issued to a person and can provide details of particulars if the cheque form is lost.

It is through a cheque that the customer can withdraw money from his current account in the bank A cheque is, therefore, an order upon a certain banker asking him to pay on demand, a certain sum of money to, or to the order of a certain person, or to the bearer of the instrument There is no condition attached to this order Its main characteristics thus are —

(1) It is an order without any condition

(2) It is drawn upon a certain banker

(3) The banker has always to pay it on demand

(4) It is payable to a certain person or to his nominee or to the bearer of the instrument

The person who draws the cheque, *i e*, the customer of the bank is called 'drawer' and he must sign his name on the right hand bottom corner The bank upon whom the cheque is drawn is known as 'drawee' and the person to whom it is made payable is known as the 'payee' Sometimes the drawer makes the cheque payable to "self" when he wants to withdraw money from the bank for himself

The Drawing of a Cheque

All cheque forms together with counterfoils are numbered and the name of the bank together with that of the branch with whom the drawer has an account is printed in bold letters There is a space left for inserting the date The drawer must be very careful in filling in a cheque form

(1) It must bear the date on which it is drawn If the date of a subsequent or following day is put in, the cheque is post-dated and will not be paid by the bank till the date mentioned therein An anti-dated cheque *i e*, one bearing a date previous to the date on which it is drawn will be paid by the banker unless it is six months old, when it is known as a stale cheque and will not be paid by the bank

(2) The person to whom the cheque is made payable is known as the payee His name must be written legibly in the body of the cheque and should not be erased, because the least irregularity will compel the banker to refuse payment.

(3) The amount must be written both in words and in figures to avoid mistakes The writer should not leave any room for changing the amount by a subsequent party to the cheque, otherwise he will be responsible for the loss if the bank pays it in good faith The amount in words and figures should be the same, otherwise the bank will refuse payment

(4) The drawer should be careful in signing his name at the right hand bottom corner and this must correspond to

his signature in the autograph book of the bank, failing which the bank will refuse payment

(5) The counterfoil must be filled in before the cheque form is torn off and handed over to the payee If a number of cheque forms are to be written at one time, the counterfoil of every cheque form must be filled in before writing a subsequent cheque form to ensure caution and avoid mistakes

From the point of view of negotiability or transferability, a cheque may be an Order Cheque or a Bearer Cheque

A Bearer Cheque can be transferred by the payee without his endorsement or his signature on the back thereof It may be delivered to the transferee with the intention of transferring the rights in it The banks in practice require the last holder of a bearer cheque to sign his name on the back although it is not necessary according to the Indian Negotiable Instruments Act

An Order Cheque should be endorsed before it can be transferred The rights in it will not be transferred to the transferee unless the payee or the transferor of the cheque as the case may be endorses it Both endorsement and delivery are necessary in this case to make the title of the transferee safe A cheque not bearing the words 'or bearer' or 'or order' will be treated as an Order Cheque

It is the drawer only who can strike out the word 'order' and write the word 'bearer' in its place and this alteration requires to be signed by him

Crossed Cheques

A crossed cheque is one on the face of which two transverse parallel lines are drawn with or without certain words in them whose effect is that the payment of the cheque can be made by the drawee banker to some other banker and the payee or the holder cannot get cash on the counter of the drawee banker

A cheque may be crossed generally or specially In case of a General Crossing two transverse parallel lines across the face of the cheque are drawn and certain words as '& Co' may be written The effect is that payment of such a cheque can be obtained through a bank only and the payee or the holder cannot get payment in cash on the counter of the bank If he does not have a banking account, he must hand it over to a friend who has a bank account He can get cash from his friend and the latter will send the cheque to his bank where his account will be credited with the amount of the cheque Examples of a general crossing are as below —

1 2 3

Special Crossing.—When inside the two transverse parallel lines across the face of a cheque, the name of a particular banker is written, it is known as Special Crossing. The effect of such a crossing is that the cheque can be paid by the drawee bank only to the banker whose name has been mentioned inside the crossing. The holder cannot get payment through any and every bank, but only through the bank named in the crossing. Such a crossing is done at the instance of the payee.

The advantage of crossing a cheque is that it becomes safer than an open or uncrossed cheque. A specially crossed cheque is better than a generally crossed cheque from the point of view of safety, because its payment can be made only through the bank named therein. Even if it is lost by the payee, he does not stand to lose anything because the drawee bank will not pay it except through the bank named in the crossing.

A cheque can be crossed by the drawee or by any subsequent party and similarly a general crossing can be turned into a special crossing. If a cheque has been crossed by mistake, it can be opened by the drawer only, and not by any other party, by writing the words 'pay cash' within the crossing. This requires the initials of the drawer. Cheques sent through post should always be crossed to avoid loss.

A banker should not disregard a crossing and if he does so and makes the payment to a wrong person, he will be personally responsible for the loss.

Not Negotiable.—At times, the words 'Not Negotiable' are written inside the general or the special crossing as the case may be. They cannot be written on an open or uncrossed cheque. The effect of these words is that the transferee, *i.e.*, the person to whom the cheque is transferred cannot acquire a better right in the cheque than is the case with the transferor. If the transferor has a safe and good title, the transferee for value can also have a safe and good title, but if the former has a defective title, the latter cannot have a better one.

These words do not prevent the transferability of a cheque which can be transferred without any difficulty, but the transferee cannot get a better right They do not impede transferability, but impede negotiability, *i e*, the transferor cannot transfer a better right, but can transfer only his title, defective or good as it is In the absence of these words in the crossing of a cheque, a person who receives a cheque in good faith, for proper value and in a proper form can acquire a good title even if the title of the transferor is not good

The words "Account Payee only" imply a direction to the collecting banker that he should credit the account of the payee with the amount of the cheque and should not pay cash for it at the counter

A stale cheque is that which has become six months old and will not be paid by the drawee banker without being referred to the drawer

A mutilated cheque is that which is torn into pieces, but pasted afterwards and if it is presented to the bank, its payment will be refused

A marked cheque is one which has been signed by the drawee banker It means that on the date of its presentment for the drawee banker's signature, there are sufficient funds in the account of the drawer to meet it

ENDORSEMENTS

In case of order cheques, bills of exchange and promissory notes, the transferee can acquire property only when they have been endorsed by the transferor or the payee Endorsement means that the payee should sign his name on the back of the instrument in order to enable the transferee to acquire title in that instrument The person who signs his name on the back of the instrument is known as the endorser and the person to whom it is transferred is known as the endorsee.

The payee must sign his name exactly as it has been spelt by the drawer in the cheque form If the spellings as written by the drawer are different from what the payee usually writes, the latter should first put down the incorrect spellings as given by the drawer and beneath them he can if he so likes write his name in the usual way

KINDS OF ENDORSEMENTS

(1) Blank endorsement or general endorsement is one where the payee or the endorser simply writes his own name on the back of the cheque and does not write the name of the transferee Of course date should be put down The effect of this endorsement is that in future the cheque becomes payable to bearer, *i e*, the transferee while transferring it to

somebody else need not himself endorse it After a blank endorsement an order cheque is treated as a 'bearer cheque'

(2) Special endorsement or endorsement in full is one where the endorser specifies the name of the endorsee in addition to writing his own name on the back of the instrument as follows —

Pay to Mr RAM NARAIN LAL *or order,*
RAM PRAKASH
15–10–33

If Ram Narain Lal transfers it to a creditor or wants to get payment from the bank he will have to make his own endorsement These two forms of endorsement are very common

(3) Restrictive Endorsement is one which restricts the further negotiation of the instrument If the endorser adds the word 'only' after the name of the endorsee, the endorsement becomes restrictive as below —

Pay to Mr RAM NARAIN LAL *only*
RAM PRAKASH
3–10–33

(4) Sans Recourse Endorsement is one where the endorser does not want to incur a contingent liability if the instrument is dishonoured on presentment Endorsement implies a contract between the endorser and the endorsee and all subsequent parties whereby the endorsee must present an instrument for payment on the due date and the endorser engages to make payment if it is refused by the drawee in due course Where the endorser does not want to incur this contingent liability, he can place a *sans recourse* endorsement as below —

SANS RECOURSE RAM NARAIN LAL,
Secretary,
The Muslim Book Shop

A cheque must be presented for payment upon the drawee banker by the holder personally or through a bank within a reasonable time He will run the risk of losing his claim against the drawer if he causes undue delay and if in the meantime the bank becomes insolvent The holder will then become an ordinary creditor of the bank This will be the case only if the drawer had sufficient funds to his credit to meet the cheque

CONDITIONS UNDER WHICH PAYMENT WILL BE REFUSED

The drawee banker will refuse payment of the cheque on presentment in the following cases and the cheque will then be said to have been dishonoured by the bank —

(1) When the customer or the drawer countermands payment, i e, asks the banker not to pay the cheque

(2) When the customer becomes insolvent and the banker comes to know of it

(3) When the drawer dies or becomes insane and the banker comes to know of it in time

(4) When a Garnishee Order is served on the banker by a law court A Garnishee Order is an order served by the court upon the banker asking him not to touch the bank balance of the judgment-debtor

(5) When the drawer has not sufficient funds to meet the cheque in his banking account In such cases the banker will write I/f or n/f, meaning insufficient funds

(6) Mutilated cheques and cheques having some irregularity on their face will also be dishonoured

BILLS OF EXCHANGE

A bill of exchange is an instrument in writing, containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument

It is the creditor who draws the bill of exchange and directs the debtor to pay a certain sum of money either to self or to somebody else There are three parties to a bill of exchange, the drawer, the drawee and the payee The drawer is the person who writes out the instrument, i e, the creditor or the seller Drawee is the party upon whom the bill of exchange is drawn and who is directed to make payment according to the terms mentioned in the instrument. Payee is the person in whose favour the instrument is drawn and he is the creditor of the drawer

It is the seller of goods who draws a bill of exchange upon the buyer and the latter pays cash after the goods purchased have been sold in the market The drawer can keep the bill till maturity, get it discounted or pass it on to a creditor in payment of debt

There are two kinds of bills of exchange, inland and foreign Inland bills of exchange are those which are drawn and made payable in the same country, i e, when the drawer and the drawee reside in British India, the bill is known as an inland bill Attention must be paid to the following points in drawing an inland bill —

1 It must be correctly dated because in some cases the date of maturity is calculated from the date on which the bill is drawn

2 The period of payment must be clearly stated in the bill It is known as the tenor or the term of the bill A bill may be payable so many months after sight or date or so many days after sight or date Month will always mean a calendar month for the purpose of calculating the date of payment In case of a bill payable after sight, the date of payment will be calculated from the date on which the bill is accepted and in the other from the date on which it is drawn

3 Amount must be mentioned both in figures and in words It must be in figures in the left hand top corner and in words in the body of the bill

4 The name of the payee should be specified in the body of the bill and the name and address of the drawee in the left hand bottom corner The drawer should sign his name in the right hand bottom corner

5 It should be properly stamped Bills of exchange payable on demand require only an anna stamp, whereas those payable at days or months after date or sight require stamps according to value

6 At the end of the body of the bill it is usual to add the words 'value received' which means that the drawee has received some equivalent value for it

FORM OF AN INLAND BILL

Bombay,
The 15th December, 1933

Rs 300-0-0

| one anna |

On Demand, Pay to OUR ORDER *the sum of Rupees Three hundred only, value received*

MR RAM PRASAD,
15, Kalbadevi Road,
POONA

For A B & Co, Ltd,
E JAMES,
Director

If the bill is payable otherwise than on demand, the assent of the drawee to pay it on the due date must be obtained This he does by writing something on the face of the instrument which indicates that he is willing to pay it according to the terms and conditions mentioned by the drawer therein This assent of the drawee is known as acceptance

Acceptance may be general or qualified In the former case the drawer agrees to pay the instrument as it is drawn without attaching any conditions from his side as in the case given below —

Accepted payable at the Imperial Bank of India,
Cawnpore Branch
RAM PRASAD
20th December 1933

Qualified acceptance is one where the drawee is willing to pay it subject to certain conditions He may accept it to pay when his goods have been sold, he may make it payable at a certain place and there only, he may agree to pay it for Rs 200-0-0 only, though it may be drawn for a higher sum or he may extend the time of payment

It may be negotiated before being accepted by the drawer and the holder is not bound to accept the "qualified acceptance" He can treat it as dishonoured and inform the parties prior to him of this fact, but if he accepts such an acceptance without the consent of the previous parties, they will all be relieved of their engagements to pay the amount of the bill to him in case of dishonour The drawee can retain the bill for twenty-four hours when it is presented to him for acceptance

Foreign bills of exchange are those that are drawn in one country and made payable in, or drawn upon a person resident in some other country These bills are generally drawn in sets of two or three Each copy is numbered and has a reference to others and all the three are sent by different mails. Such bills are stamped twice

FORM OF A FOREIGN BILL OF EXCHANGE

PARKER STREET,
£55-6-0 *London, the 15th November*, 1933.

| 9 *d* |

Ninety days after sight of this first of exchange (second and third of the same tenor and date unpaid) pay to the Allahabad Bank, Ltd, the sum of fifty-five pounds and six shillings, value received

For A B & Co, Ltd,
H ANDREWS
Manager

To
MESSRS KAPOOR & CO,
Meston Road,
Cawnpore, India

Foreign bills of exchange are usually accompanied by documents, *e g*, bill of lading, insurance policy, invoice and letter of hypothecation They are sent through banks and the banker does not give the documents to the drawee before the latter has accepted or paid the bill as the case may be. Without getting the documents and assigning them in favour of the shipping company, the buyer in the importing country cannot get delivery of goods These bills are known as documentary drafts

Every bill of exchange should be presented for payment to the drawee in due time and in the usual business hours.

The date of payment is calculated by adding three days of grace to the period of time mentioned in the bill on the expiry of which the instrument is made payable. Those payable on demand do not require any days of grace. If the date of payment falls on a holiday, the bill is payable on the next preceding business day.

Bills of exchange the acceptance or payment of which is refused require noting and protesting. Noting is enough in case of an inland bill. An official known as the Notary Public gets the particulars of the bill noted on the bill itself or on a separate piece of paper and gives the reason for dishonour. This becomes a proof of the fact that the instrument was presented for acceptance or payment and that the same was refused.

In case of a foreign bill protesting is necessary. A protest is a formal declaration under oath that the bill was presented for acceptance, payment or better security as the case may be, and that the drawee refused to comply with the demand of the holder. The particulars of the bill together with the date of presentment and the reply of the drawee are written therein.

Usance is the customary period of time allowed for drawing bills of exchange between two different countries and it depends upon the distance and the facility of communications between them.

A bank draft is a bill of exchange drawn by one banker upon another in which the drawee is directed to pay the sum of money mentioned therein to the order of a specified person or to bearer on demand. The bank issuing the draft charges commission and the money at the prevailing exchange rate has to be deposited with the issuing banker. Foreign payments are made through bank drafts and as they are payable on demand there is no necessity of getting them accepted.

FORM OF A FOREIGN BANK DRAFT

No. 4/59

CHARTERED BANK OF INDIA, AUSTRALIA AND CHINA

Exchange for £1,000 *Cawnpore, 1st December,* 1933

On demand pay this SECOND OF EXCHANGE (First being unpaid) to the order of S. P. BHARGAVA, ESQ., the sum of ONE THOUSAND POUNDS STERLING, value received.

To

W. BARTER, ESQ.
Agent

For THE CHARTERED BANK OF INDIA
AUSTRALIA AND CHINA

CHARTERED BANK OF INDIA,
AUSTRALIA AND CHINA
6104 41, Beaver Street,
LONDON

C. JONES, *Agent*
W. BROWN, *Sub-Accountant*

FORM OF AN INLAND BANK DRAFT

No 2/13

ALLAHABAD BANK, LIMITED

Cawnpore, 29th March, 1933

On demand pay to Prof K L GOVIL, M A, the sum of rupees TWO HUNDRED only

To
S JOHN, ESQ,
Agent,
ALLAHABAD BANK LTD,
MADRAS

For THE ALLAHABAD BANK, LIMITED.
T JAMES, *Agent*
R BAHRI, *Accountant*.

Hundis are like bills of exchange and are very widely used by the traders in Bombay, Calcutta Delhi, Cawnpore, etc They are governed by customs and usages prevailing in the mercantile community and in some cases they are also governed by the Indian Negotiable Instruments Act They are drawn in *Mundia* in Northern India They are either payable on demand or after sight In the former case they are called *Darshani Hundis* and in the latter *Miti Hundis*

A promissory note is an instrument in writing containing an unconditional undertaking signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person, or to the bearer of the instrument It is not the same as a bank note or a currency note It does not need acceptance and there are only two parties to it, the maker or the drawer and the payee who is the creditor of the drawer

CHAPTER XVI

Defects of the Indian Money Market

THE Indian money market is not as efficiently organized as the money markets of Western countries. There is no central co-ordinating agency in the Indian banking system. The Imperial Bank of India does not act as a true bankers' bank. Owing to the special privileges enjoyed by it, the joint-stock banks regard it as an unfair rival. Foreign exchange banks also are regarded with suspicion by the joint stock banks on account of their large resources and ability to attract funds at lower rates. Their penetration into inland business, both at the ports and in the interior, is regarded as an encroachment by Indian joint-stock banks. The primary credit co operative societies do not come into contact with any constituent of the Indian money market except the central co-operative agencies.

The provincial and central co operative banks keep small current accounts with the Imperial Bank and the provincial co operative banks have also cash credit facilities with the Imperial Bank. The latter has recently insisted that the co operative paper should be replaced by government securities as a basis of cash credit facilities. The co operative banks are doing commercial banking also, *e g*, opening current accounts, purchasing commercial paper, selling remittance, etc, and hence they are regarded as competitors by the Imperial Bank, the joint stock banks and the indigenous bankers.

There is no regular connection between the indigenous bankers and the co operative banks except that money-lenders have recently begun to keep deposits in the central banks and some of them also act as directors of central banks. There is no close connection between the Imperial Bank and the joint stock banks, and though the latter keep their balances with the former there is no legal provision compelling them to do so. In times of stringency they cannot depend always upon the Imperial Bank. The *shroffs* also do not ordinarily keep accounts with the Imperial Bank, and if they do so it is with a view to facilitate remittance or to facilitate payments of bills drawn upon them by outside merchants. In the busy season, a temporary link is established between the *shroffs* and the Imperial Bank when the former cannot independently handle all the *hundis* without the help of the latter. The rediscount facilities are also subject to certain maximum limits based upon the financial standing of the approved *shroffs*.

probably, than in Calcutta They are not a very serious factor to be reckoned with Unlike the position in the London money market, holding of bills is not on a very large scale. When purchased they are regarded as a definite investment and are not frequently re discounted Export bills are generally placed on the London discount market, while import bills are held till maturity by the banks Inland bills sometimes, specially in the busy season, go to the Imperial Bank

The Imperial Bank rate has a different significance from the bank rate in the London money market It is the rate at which the Imperial Bank is prepared to grant loans on government securities The *hundi* rate is the rate at which the Bank is prepared to discount or re-discount first class bills of 61 days' date The *hundi* rate is sometimes higher and sometimes lower than the Imperial Bank rate, while the London money market rate is always lower than the bank rate The following table shows the differences between the bazar rates, the call money rates and the Imperial Bank rate —

	Bank Rate	Call Money Rate Calcutta	Call Money Rate Bombay	Imperial Bank Hundi Rate	Bill Bazar Rate Calcutta	Bill Bazar Rate Bombay
			April 1, 1926 to March 1, 1927			
	%	%	%	%	%	%
April	6	4½	5½	6	10–10½	9¾
May	6	4	4¾–5	6	10–10½	9¾
June	5	2	4	4	10–10½	7⅞
July	4	2¼	2½	4	10	7⅞
August	4	1	1	3	10	6¾
September	4	1	1	3	10	6¾
October	4	½	½–1	3	10	6¾
November	4	¾	½	3	10	6¾
December	4	¾	½–¾	3	10	6¾
January	5	4	4½	4½	10	8⅝
February	6	4¾	5–5½	6	11	9⅜
March	7	6	6½–6¾	7	11	10½
			April, 1, 1929 to March 1, 1930			
April	8	5	6½	8	11–12	11
May	7	2½	3½	7	10–11	8¾
June	6	1½	3¼	6	10–11	6¾
July	5	1½	1½	5	10	5 [illegible]/16
August	5	Nil	1½	5	10	5 5/16
September	5	1½	1½	5	11	6
October	5	2½	3–3½	5	11	7 3/16
November	7	2	2½	7	11	8¾
December	7	1½	4½	7	11	9 1/16
January	7	3	5	7	11	9 1/16
February	7	4½–5¼	6½	7	11	9¾
March	7	5	4¾	7	11	9 1/16

The bazar rates are those of small traders' bills. The Calcutta bazar rates are higher than Bombay bazar rates, the former varying between 10 and 11 per cent. The Bombay bazar rates seem to have some remote connection with the call money rate and the bank rate. "The fact that a call rate of $\frac{3}{4}$ per cent, a hundi rate of 3 per cent, a bank rate of 4 per cent, a Bombay bazar rate of $6\frac{3}{4}$ per cent, and a Calcutta bazar rate of 10 per cent can exist simultaneously indicates an extraordinary sluggishness in the movement of credit between the various money markets."

In India the call money rate is independent. In other money markets of the world the rates for day-to-day loans, short loans, emergency money, "night" or "bad" money, are much lower than the bank rate, because call money is lent for about twenty-four hours and is repayable either at the option of the borrower or the lender. Advances on bank rate are for a specific period repayable at the option of the borrower only. Therefore the bank rate is always higher than the rate on day-to-day loans. The latter tends towards the rate at which banks attract demand deposits or current account deposits. These deposits are with banks for the time that the depositor pleases and the latter can get them from the bank on demand. Hence the amount of such deposits cannot be lent by banks for a specific period of time and as such it can be lent at very low rates of interest, about 1 per cent. In India the case is different. In the slack season call money is unlendable at any rate in the absence of treasury bill issue, but in the busy season it is not available at bank rate even. In other countries, the central banking agency takes away surplus funds from the market and supplies funds to the market when necessary. In India, owing to the absence of a central bank, the money market is not properly controlled.

In India there are two money markets, the Indian bazar for small traders' bills and the market controlled by institutions run on western models. There is no discernible link between the two, because the bill business is not developed in India. The Bank of England controls money rates in London as well as in large centres. In the pre-war days the Bank of England controlled the money market by relieving it of surplus funds, by taking upon itself the mantle of the borrower. "What Bank of England did was to sell Consols for cash and to buy them back for the 'account', the 'account' being the monthly settlement day which used to rule on the stock exchange before the War. Purchasers of Consols for cash were required to pay for them the following day and, the payments being made in the usual way by cheques on their bankers, the net result was that, after the cheques had passed through the London clearing, the bankers' balances at the

Bank of England would be correspondingly reduced with the supply of money reduced to that extent, borrowers would go unsatisfied unless they paid the higher rates, since the remaining money would have a scarcity value" (See *The London Money Market*, 4th Edition, pages 101 and 102, by W F Spalding) During and after the War the treasury bill sales of the British Government have been a ready and effective means of absorbing any surplus funds of the market. In India there is considerable divergence in rates in provincial towns

The banks deposit rates in London follow the bank rate automatically, but that is not the case in India because of a lack of highly-organized money market in our country

The seasonal monetary stringency in India is sought to be removed by the Government by placing, at the disposal of the Imperial Bank, a loan amounting to Rs 12 crores against 91 days' first class bills No issue can be made until the bank rate rises to 6 per cent The loan bears interest at a minimum rate of 6 per cent for the first 4 crores and 7 per cent for the next 8 crores The fixing of arbitrary rates for the issue of additional currency unnecessarily penalizes trade and commerce To think that the seasonal monetary stringency in India is inevitable and that it must bring about a wide range of interest rates is fundamentally wrong and is due to the defective system of control and credit The Reserve Bank, when established, will keep sufficient cash reserves in the slack season to supply the needed currency in the busy season at reasonable rates The present system of issuing emergency currency at stated rates is responsible for the existing position

The Government controls the Indian money market to a very great extent The Royal Commission on Indian Currency and Finance, 1926, wrote as follows —"The Government controls the currency The credit situation is controlled as far as it is controlled at all by the Imperial Bank With divided control there is likelihood of divided counsels and failure to co-operate" It may be said that in recent years the Government has been controlling credit also through the sale of treasury bills Since 1925–26 about Rs 180 crores of treasury bills have been sold by the Government at varying rates of interest which except on the last issue, have been very high This has raised the price of credit and penalized trade and industry The Finance Minister of India said as follows before the Federation of Indian Chambers of Commerce in Delhi on April 8, 1931 "The chief basis of criticism is that in India it is the Government that is the chief currency authority, while, in other countries, it is the central bank Government's actions are liable for criticism much more than

those of a bank and more so when there is a so-called alien Government "

The foreign experts have summarized the defects of the Indian money market as follows —"According to the unanimous opinion of all who have expressed their views on the subject, the Indian money market shows several defects It cannot be compared with the highly-developed money markets of Western countries As a matter of fact, two money markets exist in India, the central money market and the bazar money market They have their own agencies and different rates of interest without sufficient co-ordination The central market is to a large extent dominated by the Government, which controls the currency and exercises a decisive influence on the bank rate

"The control of currency and of credit in India is in the hands of two distinct authorities, the Central Government and the Imperial Bank This system results in a serious lack of elasticity and stability of monetary conditions, the fact that the annual range of interest rates in India is wider than in other countries proves the defects of the present system A range of 3 per cent is quite ordinary in India, and this must have a detrimental effect on the economic life of the country

"It seems to have been accepted as an axiom that seasonal monetary stringency is inevitable and that this stringency must bring about such wide ranges of interest rates as are experienced

"In our opinion this conception is wrong It is one of the tasks of a properly managed and well-organized Reserve Bank to tide over busy periods when money is in strong demand without unduly raising the bank rate The absence of a mechanism, which by expanding credit can meet the seasonal demand for money, is mainly responsible for the variations in the bank rate.

"In this respect the position of the Imperial Bank ought to be considered It is the Government banker and in connection herewith its task is limited by law The most important restriction consists in its being shut out from foreign exchange business The bank acts as the bankers' bank without having the right to issue bank notes as the currency is controlled by the Government This results in the Government practically dominating the bank rate and the money market " (See Enclosure IV, page 648, *Central Banking Committee Report*)

The obvious remedy for these defects of the Indian money market seems to be the establishment of a Reserve Bank as early as possible The Indian money market will then in

course of time become like those of Western countries, with an effective bank rate To what extent will the type of Reserve Bank that is soon going to be established in this country be able to remove these defects and bring the Indian money market to the level of the money markets in Western countries will be known in course of time

CHAPTER XVII

Reserve Bank

The necessity of the establishment of the Reserve Bank in India at an early date cannot be over-emphasized It is calculated to help India 'to move forward towards that financial and economic development with the granting of additional financial and banking facilities for Indian agriculture, Indian commerce, and Indian industry, which has been the theme of one Commission and Committee after another We shall see the development of a discount market and acceptance business, of increased facilities for the marketing of produce and, in short, a gradual mobilization of India's immense potential capital for the development of India's own resources'[1] The establishment of such a bank is widely desired in India so much so that the establishment of All-India Federation has been made conditional upon the establishment and proper functioning of a sound Reserve Bank in the country

History

It will be well to refer briefly to the history of the question of a Reserve Bank for India In 1836 a number of merchants interested in the East India Company submitted to the Court of Directors a scheme for a great banking establishment for British India and claimed certain advantages for it It was expected to facilitate the use of British capital and to finance English commerce, it was to give stability to the Indian monetary system and it was to be of great convenience to the East India Company in connection with its financial arrangements, specially in relation to the management of revenue receipts in India and the remittance of 'Home Charges' This scheme did not materialize The idea of the establishment of a Central Bank for India found favour with Indian public opinion seriously after 1920 when the International Financial Conference that met in Brussels in 1920 passed a resolution to the effect 'that in countries where there is no central bank of issue, one should be established' Since then, new central banks of issue have been established in many civilized countries of the world and the old ones have been thoroughly overhauled

A Central Bank of Issue is necessary for the development of the banking resources of the country In times of need banks will be able to obtain larger resources from it and a

[1] Speech of Sir Basil Blackett introducing the Reserve Bank Bill in 1927

national control over sound and elastic currency and credit system would be secured through it, because the Bank is expected to be wholly free from the influence of domestic or foreign political pressure It will have the monopoly of note issue and will therefore act as the channel for the output and intake of the legal tender currency In the new bank paper, the country will find the bulk of legal tender money in circulation and the Government will be freed from its control over currency It will hold the Government treasury balances, currency reserves and statutory reserves of other banks and will thus be able to pool all the cash resources of the country which now lie widely scattered without any systematic and unified control It will provide emergency currency by rediscounting approved bills of exchange or by granting advances on approved promissory notes of the commercial banks and will thus provide the necessary elasticity to the Indian currency system which is the *sine qua non* of a stable monetary system The temporary pressure to which the small banks are liable will be relieved and sound banking establishments will be promoted 'Its self-denying ordinance in the matter of dividends its insistence on a high standard of banking its efficient management of currency and its detached eminence from the ordinary commercial banks of the country, would enable it to regulate our national monetary and financial matters in the real interests of the country Desirable changes in bank reserves currency cheque collections Government finance, credit policy, gold movements and the money market can be secured only through the instrumentality of a Central Bank of Issue The starting of a Central Bank would soon enable the country to realize that the bank rate and a wise discount policy can shower such inestimable advantages as credit expansion, suitable both in point of time and degree stable foreign exchanges, regulation of gold movements and maintenance of price-levels at a reasonable stability '[2] Inequality in the rates of interest in the different money markets in India will be obviated by transference of money from place to place through the instrumentality of the Bank

CAN THE IMPERIAL BANK BE TURNED INTO A CENTRAL BANK?

The Hilton-Young Commission definitely rejected the idea of turning the Imperial Bank into a Central Bank of Issue in India In this connection the Commission wrote, 'The idea of utilizing the existing organization of the Imperial Bank is tempting at first sight, but on close consideration it will be found that whatever advantages there may be in this course, the disadvantages outweigh them "

"If the Imperial Bank were required to discharge the duties of a true Central Bank its Charter would have to be

[2] *Present-Day Banking in India*, by Dr Ramachandra Rau, p 63

amended radically in the direction indicated. It would thus be precluded from undertaking a great many tasks which it now successfully performs as a commercial bank. The country would then lose the benefit of the elaborate and widespread organization which has been set up, through the length and breadth of India, to make available to the community the increased commercial banking facilities, which are so urgently needed, and to assist in fostering among the people as a whole, the habit of banking and investment. This consideration alone negatives the idea of disturbing the present functions of the Imperial Bank. It suggests, on the contrary that that bank should be freed altogether from the restrictions which its present charter imposes upon it and which clearly have their origin in the hybrid character of the functions which were originally assigned to it. When those of a purely central banking character are taken over—as they should be—by the new Central Bank, there is no longer any reason why the Imperial Bank should not be as free and unencumbered in its sphere of activity as any other of the commercial banks. Its important task of giving India the widespread banking facilities which it needs will thereby be facilitated.

"A middle course which has been suggested and which has for its objects a gradual process of what may be termed 'decommercialization' of the Imperial Bank is equally unattractive. The proposal is to confine the Bank's functions to those of a true Central Bank in the centres where adequate commercial banking facilities exist and to permit it to do the ordinary commercial banking business in all those localities where apart from the Imperial Bank, there is no other reputable bank established. It is proposed that only when in these localities one or two commercial banks have opened their establishments should the business of the Imperial Bank's branch be *restricted to that of a Central Bank*. This proposal suffers in the main from the same disadvantage that attaches to an immediate and complete conversion of the Imperial Bank into a Central Bank. Under it the Imperial Bank would be eliminated from the field of commercial banking in all the important centres and the wholesome competition it provides would thus be lost, while its hybrid character would be likely to weaken its functions both as a Central Bank in the important centres and as a commercial bank in the smaller centres."

"We come, therefore, to the conclusion that the proper course to take is to entrust the central banking functions to a new organization endowed with a charter which wholly conforms to the requirements of a true Central Bank."[3]

---

[3] *Report of the Royal Commission on Indian Currency and Finance*, pp. 35-36.

The Hilton-Young Commission recommended the creation of a private shareholders bank having local head offices in the chief business centres managed by local boards elected by shareholders of every centre separately The Central as well as the Local Boards were to be independent of political control and a small minority was to be nominated by the Government The Central Board was to consist of 14 members of whom nine would be elected by shareholders, a maximum of three would be nominated by the Governor-General in Council and a Managing Governor and Deputy Managing Governor were also to be nominated by him The Government was to be entitled to nominate an official member to the Board without having a right of vote The 14 members were to be appointed as below —

(a) The Presidents and Vice-Presidents of the Local Boards and one more elected member from every Local Board for a period of two years

(b) A wholetime Managing Governor and a Deputy Managing Governor for five years to be appointed by the Governor-General in Council, their remuneration and allowance to be determined by the Central Board

(c) A maximum of three to be nominated by the Governor-General in Council to hold office for one year only They could not be Government officers and were entitled for remuneration

A fully paid-up capital of Rs 5 crores was to be raised and the shareholders of the Imperial Bank were to be given the first opportunity to purchase the shares of the new Bank The amount of the capital recommended was small for two reasons Firstly, the shareholders should get as good a return as possible and if the amount of capital was great, a good return was not possible Secondly, the Government were to be entitled to a share in the profits of the Bank after

---

Sir Purushottamdas Thakurdas did not agree with this view and favoured the conversion of the Imperial Bank into a Central Bank He did not think that the course would retard the development of commercial banking and branch banking in India which he regarded as very necessary but that other commercial banks would do that business in place of the Imperial Bank He also pointed out that if two Banks—a separate Reserve Bank and the Imperial Bank—existed side by side, enough business for the Reserve Bank would not be found Either it would not get enough bills to rediscount unless it competed with the Imperial Bank and the Central Bank and the Imperial Bank would compete with each other or the former would not find sufficient scope for business to employ funds 'Why multiply, if it can be avoided, institutions, supported by Government balances?" See Paras 61–64 of the *Note of Dissent* by Sir Purushottamdas Thakurdas, to the *Report of the Hilton-Young Commission*

the shareholders had got a fixed preferred dividend If the capital was to be very large, the profit which would accrue to the Government would be considerably reduced on account of the preferred dividend on non earning capital

In accordance with the Resolution of the International Financial Conference of Brussels (1920) and of Genoa (1922) to the effect that Banks, and specially Banks of Issue, should be free from political pressure and should be conducted solely on lines of prudent finance," the Commission recommended that a private concern should be established As it was to rediscount bankable bills held by commercial banks, the Board of the Bank could not consist of representatives of commercial banks

No shareholder was to have more than ten votes and this provision was recommended to prevent a certain section of the shareholders from acquiring a monopoly of control The Local Boards were to be invested with powers to approve or refuse to approve transfers of shares to prevent the multiplication of an individual's voting power by transfer to nominees

The profits were to be divided as follows —

"After making provision for bad and doubtful debts, depreciation in assets, and all such items as are usually provided for by bankers, and after payment out of the net profits of a cumulative dividend at the rate of 5 per cent per annum on the paid-up capital, there should be allocated to the reserve fund, until such reserve fund is equal to 25 per cent of the paid-up capital, three-quarters of the surplus, and one-quarter to the Government Thereafter, until the Reserve Fund is equal to the paid-up capital of the bank, one-half of the surplus should be allocated to the reserve fund and the other half to the Government When the reserve fund is equal to the paid-up capital of the bank, one-eighth of the surplus, but not exceeding three per cent of the paid-up capital, should be paid to the shareholders, and the balance to the Government " (*Report of the Hilton-Young Commission*, page 40)

The Commission rejected the fixed fiduciary issue system of reserves because it would not provide the necessary elasticity to the currency system in the country In England it had done so owing to the development of cheque habit The proportional reserve system was, therefore, recommended The minimum percentage of gold or gold securities could be exceeded for a temporary period on the payment of a tax on the deficiency and with the consent of the Government

The Bank Act was to include provisions requiring every bank or banker transacting banking business in India to keep with the Reserve Bank minimum balance equal to ten per cent of demand liabilities and three per cent of time liabilities

Business of the Bank

The Bank was to perform the business ordinarily undertaken by Central Banks of Issue in other countries The Bank was not to undertake open market operations, but the charter was to include provisions authorizing the Bank to apply to the Government for power to buy and sell in the open market bills of exchange, promissory notes or other commercial paper arising out of *bona fide* commercial or trade transactions bearing *two or more good signatures* and having a maturity not exceeding 90 days The Governor-General in Council was to give due consideration to the effect upon other interests concerned of his refusal or permission to enable the Bank to do so

The Reserve Bank was to be entrusted with all the remittance operations of the Government in India and in London and the Government was thus to cease to deal in the exchange market This power was necessary for the Bank to maintain the external value of the rupee The Secretary of State was to furnish to the Bank in advance through the Government of India, periodical information as to his requirements which could be approximate only and not exact

With regard to the method of remittance that has to be employed by the Bank the Commission did not like to fetter the discretion of the Bank but left it free to follow the most suitable method The sterling purchase system in India in place of the sale of Council bills in London was introduced before the Commission made its recommendations It could be made privately and through public tender also The former involved secrecy and favouritism and the objection against the latter was that it was conducted by the Secretary of State in London The Commission held that the method of public tender could be employed in India with as great a convenience and facility to the commercial public as the public tender system in London The Commission did not recommend any definite method to be pursued by the Bank, but left it to its discretion

In 1927 the Government framed a Bill along these lines proposing a shareholders' Bank with commercial directorate and a new agreement with the Imperial Bank It was referred to a Select Committee the majority of whom favoured a State Bank because a shareholders bank would involve domination of the Bank by big capitalists in the cities and that only a State Bank could inspire confidence among the people in India Difference of opinion arose on the question of directorate also The majority proposed a Board of 15 Governors and one officer with a majority of Indian elected members of the Legislature and another three to be similarly

elected by the Provincial Legislatures to represent agricultural interests. The Governor and Deputy Governor were to be Indians as also the two directors to be appointed by the Governor-General in Council. Two directors were to be elected by the Associated Chambers of Commerce, two by the Federation of the Indian Chambers and one director was to be elected by the provincial co-operative banks. The nominee of the Governor-General in Council was not to enjoy voting power.

In August 1927, the scheme of a State bank was incorporated in the bill, but no agreement could be reached with regard to directorate. The Government wanted to disqualify a member of the Legislature from being a director of the Bank and the House was strongly opposed to the proposal of the Government to delete the recommendation of the Select Committee that the Governor and the Deputy Governor must be Indians. The Government refused to proceed with the Bill as there was no agreement on the question of the directorate of the bank.

In 1928 the Government published a new Bill embodying a scheme of a shareholders' bank. It provided for a wide distribution of share capital by limiting the face value of shares to one hundred rupees and by limiting the amount to be subscribed by an individual. The members of the Legislature were not to become the directors. The president sprang a surprise on the House by refusing to call upon the Finance Member to move the bill on the ground that the rules of parliamentary procedure did not allow him to do so unless the old Bill was formally withdrawn or had lapsed. The Government then decided to proceed with the old Bill of September 1927, but later on announced that they had no intention of proceeding with the Bill in view of the uncompromising attitude of the House. Subsequently the Central Banking Enquiry Committee with Sir B. N. Mitra as chairman was appointed to make an exhaustive banking survey. The ruling of their chairman prohibited them from laying down the constitution of the Reserve Bank, but they proceeded to recommend the creation of a Reserve Bank on the following assumptions:—

"(1) The Reserve Bank would be established by an Act of the Indian Legislature.

(2) The capital of the Bank would be provided by the State.

(3) The Bank would be under Indian control, and

(4) The Bank would be free from interference from executive or legislature (Indian or British) in its day-to-day administration."

They further wrote as follows:—

"It must be clearly understood that all the recommendations in our Report which envisage the establishment of a Reserve Bank are based on these assumptions We may add in this connection that the foreign experts have expressed the opinion that a Reserve Bank can be run on sound lines whether it is formed as a State Bank or as a Shareholders' Bank, provided that the Bank is kept free from interference by Government in its daily administration "[4]

RECOMMENDATIONS OF ROUND TABLE CONFERENCE

The Federal Structure Sub Committee of the First Round Table Conference recommended that 'with a view to ensuring confidence in the management of Indian credit and currency, efforts should be made to establish on sure foundations and free from any political influence, as early as may be found possible a Reserve Bank which will be entrusted with the management of currency and exchange The Financial Safeguards Committee of the Third Round Table Conference made the establishment of federation dependent upon the establishment and proper functioning of a Reserve Bank in India They recommended that "The Committee are of opinion that the proposals to be submitted to Parliament should be based on the assumption that such a Reserve Bank would have been created prior to the inauguration of a federal constitution and recommend that steps should be taken to introduce into the Indian Legislature a Reserve Bank Bill conceived on the above lines as soon as possible Certain requirements must be satisfied before the Reserve Bank could start operations with a reasonable chance of successfully establishing itself, in particular that the Indian budgetary position should be assured, that the existing short-term debt both in London and India be substantially reduced, that adequate reserves should have been accumulated and that India's normal export surplus should have been restored " In the *Report* of the Committee it was also placed on record that 'the Secretary of State undertook that representatives of Indian opinion would be consulted in the preparation of the proposals for the establishment of the Reserve Bank including those relating to reserves '

The Reserve Bank Committee was appointed in response to that undertaking and it made its recommendations on the strength of which the Reserve Bank Bill in the Legislative Assembly was introduced on September 8, 1933, and subsequently referred to a Select Committee

MAIN RECOMMENDATIONS OF THE RESERVE BANK COMMITTEE.

A private shareholders bank free from any political control should be established

[4] *Report of the Indian Central Banking Enquiry Committee*, para. 606 pp 418–419

The shares of the Bank should be of Rs 500 each and on this basis they recommended 'that the minimum voting qualification should be two shares which must have been held for at least six months and that the maximum number of votes that may be exercised by any one shareholder should be ten ' With this limitation on the voting power the Committee did not think it necessary to place any restriction on the amount of the capital to be held by any one shareholder

The majority of the Board of Directors should derive their mandate from the shareholders and to ensure the representation of all important elements in the economic life of the country, they recommended 'that a minority of the Board should be nominated by the *Governor-General in Council* under the present constitution and by the Governor-General *at his discretion* under the new constitution, it being understood that this power would be exercised to redress any such deficiencies ' There were to be fifteen or sixteen members of the Board as follows —

8 Directors to be representatives of Shareholders,
4 Directors to be nominated by the Governor-General in Council,
1 Governor,
1 or 2 Deputy Governors with no voting power,
1 Officer of the Government with no voting power

Appointment of Directors

It involves the division of India including Burma into five areas, election by shareholders resident in each area of members of the local board and selection by the latter from among themselves of the directors to represent their respective areas

Appointment of Governors and Deputy Governors

The Committee emphasized the importance of appointing the Governor and Deputy Governors of the Bank in such a way that they must command general confidence both in India and abroad The majority of the Committee held that the Governor-General *in his discretion* should be the authority to appoint the Governor and the Deputy Governor or Governors when the new constitution came into force Before appointing them the Governor-General would ascertain the views of the Board of the Bank The minority held that these appointments should be made by the Board of Directors subject to the approval of the Governor-General It was finally recommended that in order to harmonize these views it was necessary that the Governor and Deputy Governors should be appointed by the Governor-General after consideration of the recommendations of the Board of the Bank Except four, all members accepted this solution

Share Capital and Share Registers

The original share capital of the Bank was recommended to be Rs 5 crores divided into shares of Rs 500 each which should be fully paid A separate register should be maintained in each of the five areas and the shares should be transferable from one register to another so that there would be a free market in them But shareholders should only be entitled to vote in respect of the areas in which they are resident.

Duties of Local Boards

The Local Boards are to be a sort of machinery to appoint the directors and their duties are those as may be delegated to them by the Central Board They would be purely advisory bodies but they would play a valuable part in the scrutiny of commercial power Their functions would be analogous to the functions of the Discount Committees in Bulgaria, Belgium, Japan and Lithuania The Central Board should be empowered to nominate to each local board not more than three additional members who are to be full members of the Board except that they should not be eligible to be returned as representatives of the area on the Central Board and are not to take part in the selection of such representatives

Branch in London

The establishment of London Branch of the Bank is made optional unlike the provision of Clause 6 of 1928 Bill and if the Bank of England is employed as its London Agent by the Reserve Bank, the Bank of England is expected to employ the Reserve Bank as its agent in India

Structure of the Bank

Like the Bank of England, the Reserve Bank is to be divided into two departments, the Issue Department and the Banking Department

Business of the Bank

The Central Banking Enquiry Committee in paragraph 607, pages 419 and 420, recommended that an additional provision should be made enabling the Bank to make loans and advances on the security of moveable goods, wares and merchandise as well as against warehouse warrants and warehouse receipts representing such goods The London Committee did not recommend any such provision because in their opinion it would tend to render the Bank's resources less liquid and might involve it in undesirable competition with commercial banks (Paragraph 17 of the *Report*) The Central Banking Enquiry Committee had written in this connection as follows —

'This provision may perhaps be criticized as likely to encourage too much competition between the Reserve Bank and the other commercial banks in the country We agree that the Reserve Bank should not ordinarily compete with commercial banks for profit, but in our opinion it ought to be in a position to operate in the open market and compete with the commercial banks so as to make its policy effective We contemplate that the Reserve Bank need not necessarily avail itself of this provision to a large extent, but the mere fact of its existence will enhance its influence on the level of interest rates We might also draw attention to the fact that a number of the recent modifications to the South African Reserve Bank Act have been on the above lines, the object being to render its working more effective (Paragraph 607, pages 419 and 420 of the *Report*)

Open Market Operations

The Bank should undertake open market operations. According to the Bill of 1928, the meeting of the Board on each occasion was necessary to utilize such powers The Committee recommend that the Board can delegate to the Governor powers in this respect and a meeting of the Board is not always necessary to determine the question of utilizing open market operations (Paragraph 18 of the *Report*)

Exchange Obligations of the Bank

The Committee lay down that in the present state of monetary disorganization in the world, it is impossible to incorporate in the Bill provisions which would be necessarily suitable when monetary systems generally have been recast and stabilized The sterling standard is considered the best standard for India and the exchange obligations are to be in accordance with the rupee sterling ratio existing at the time of the introduction of the Bill There is to be no change in the *de facto* situation by the mere coming into operation of the Reserve Bank The majority of the Indian delegates regard the question of a suitable exchange ratio as one of the essential factors for the successful operation of the Reserve Bank and in their view it is for the Government of India and the Legislature to examine the relevant considerations to see that minimum possible strain is placed on the currency system of India The Committee lay down that the whole question of monetary standard best suited to India will have to be reviewed when the international monetary position has clarified itself and become sufficiently stable to make it possible to frame more permanent provisions The practice to which the public has at present become accustomed is recommended to continue and the position as if the rupee was still on the gold basis has been assumed as correct

Assets and Liabilities of Issue Department

The rupee redemption fund is recommended to be dispensed with as in the opinion of the Committee the future return of rupees over a series of years is likely to be considerably less than in the past years The scheme given below is to be adopted —

(1) The amount of rupees transferred to the Bank at the outset should not exceed rupees fifty crores

(2) The surplus amount of rupees which the Government is to remove from the reserve as a result of this arrangement should be held by the Government in a separate account and silver is to be held as bullion, not as coin

(3) In any year in which the minimum holding of silver rupees by the Bank exceeded fifty crores or one-tenth of the total amount of the reserve, the Bank should hand over the surplus to the Government to an amount not exceeding five crores of rupees in any one year The Government would pay full value for these rupees Forty per cent of this value can be paid in sterling or foreign assets acceptable to the Bank provided the Banks' external assets did not exceed 50 per cent of its total reserve at that time

(4) If in any year the Bank's maximum holding fell below the amounts indicated above, the Government should have the right to sell rupees to the Bank up to a maximum of rupees five crores in any one year As the specific rupee redemption fund is to be omitted the Committee think it necessary that at the outset the reserves of the Bank should provide an ample margin over the statutory amount

According to clause 33 of 1928 Bill gold and sterling assets initially should not be less than 50 per cent of the amount of the liabilities of the Issue Department The Committee do not propose any alteration, but suggest that the case should be examined by the Government of India in the light of all prevailing circumstances

Government of India Rupee Securities

The Committee recommend that the question of the holding of the Government of India rupee securities should be further considered in India as it was suggested that the limits proposed in the second *proviso* of clause 31 (3) of 1928 Bill, may be unduly restrictive of the Bank's open market operations policy

The remainder of the reserve should consist of sterling securities and gold coin or bullion Gold securities should be replaced by sterling securities as the holding of the former would be inappropriate to the sterling standard and might

be a possible source of weakness in the existing state of uncertainty Sterling securities and gold coin or bullion are to be 40 per cent of the total reserves of the Issue Department as proposed by the Hilton-Young Commission and embodied in 1928 Bill

PROPORTION OF STERLING SECURITIES AND GOLD

The Committee recommend a minimum gold holding of rupees thirty-five crores which represents about 20 per cent of the present note liability The Committee argue that as long as the rupee is not based on the gold standard, there is no logical necessity of prescribing a minimum holding of gold and further as gold carries no interest, gold holdings will unnecessarily reduce the profits of the Bank For these reasons a substantial amount of sterling is always to be kept to fulfil sterling obligations But as there is a widespread feeling in India in favour of a gold holding as the most reliable form of reserve the Committee recommend a minimum gold holding of rupees thirty-five crores

The existing gold assets are to be valued at the existing old parity which would provide a cover against loss by a wide margin The Bank in this way might obtain a large premium on the gold handed over to it by the Government If sales take place in the intermediate period pending the revaluation of gold, the Committee hold that in principle such profits should belong to the Government 'But our view is that this unrealized margin should in some way or other be kept available for strengthening the position of currency reserves We recommend that the detailed proposals should be worked out by the Government of India for consideration during passage of legislation on this subject'

SUSPENSION OF RESERVE REQUIREMENTS

The Committee recommend a suspension of reserve requirements and the utilization of minimum reserves whenever necessary subject to the payment of a tax

RESERVE FUND AND ALLOCATION OF SURPLUS

The Committee approve the provisions for reserve fund and allocation of surplus as laid down in clause 46 of the 1928 Bill subject to certain modifications in respect of distribution of dividends The rate for fixed dividend must depend to some extent on the return on comparable securities at the time of issuing shares The Governor-General in Council is to be empowered to fix this rate subject to the maximum of 5 per cent The dividend is to be gradually increased up to the maximum of 6 per cent as laid down in the 1928 Bill. In determining the fixed rate of dividend account is to be taken by the Governor-General in Council not only of the

yield of long-term Government securities but also of the possibility of attracting the small investor in the mofussil and thereby securing a wide distribution of shares

SCHEDULED BANKS

According to clause 14, sub clause 7 of the 1928 Bill the Governor General in Council has the power to include in the First Schedule any company which comes under section 2 of the Indian Companies Act and which is carrying on banking business and has a paid-up capital and reserve of an aggregate value of not less than three lakhs of rupees Such banks are known as Scheduled banks They are to maintain with the Reserve Bank a minimum balance of not less than $7\frac{1}{2}$ per cent of the daily average of the demand and $2\frac{1}{2}$ per cent of the daily average of their time liabilities in India The Committee recommend that the question of minimum balance and whether the criterion should be based on the amounts of deposits rather than on the paid-up capital and reserves should be considered (Paragraph 28 of the *Report*)

RELATIONS OF RESERVE BANK WITH IMPERIAL BANK

The Committee recommend that the Reserve Bank should be required to enter into an agreement with the Imperial Bank according to clause 45 of the 1928 Bill but the period of 25 years is considered too long and this question is to be further considered by the Government The agreement is to be terminated on several years' notice on either side Its continuance is to be dependent on the maintenance of sound financial position by the Imperial Bank It has been further recommended that the Imperial Bank should be the sole agent of the Reserve Bank at all places in British India where there is a branch of the Imperial Bank of India and no branch of the Banking Department of the Reserve Bank It applies to those branches only which exist at the time the Act comes into existence The Reserve Bank should be under no obligation to entrust the agency business to branches of the Imperial Bank which come into existence in future and is to be free to make its own arrangements It was suggested to the Committee that a part of the share capital of the Reserve Bank should be allotted to the shareholders of the Imperial Bank as a sort of compensation, but the Committee have not recommended any special allocation of the Reserve Bank shares to the shareholders of the Imperial Bank as it would be inconsistent with their scheme of a wider distribution of shares They admit that the question of compensation should receive due consideration, but there should be some other form in which it is to be paid if admitted (Paragraphs 29–31 of the *Report*)

Secretary of State in his reply to question No 8599 undermines the foundations of the agreement arrived at, and if it is persisted in makes the consideration of the alternative of a Bank an imperative necessity ' [5]

Thirdly, he refers to the growing feeling in England that there should be greater control of the Bank of England by the Government and that the constitution and conventions of the Bank of England should be changed and that the management of the currency should not be substantially independent of the political feelings of the general body of the community Referring to these feelings he says that "they should exist is a significant fact, should they gain force and be expressed in legislation, what will be the position in India? My country will have a real grievance if, on what may be the approximate eve of a change in the historic relations between the Government of the day and the Bank of England leading to greater political control of the Bank, India finds herself closely tied to a system which England from experience has to reject " He mentioned this fact for the guidance of the Joint Select Committee that it is undesirable to create in India the feeling that the country is being irretrievably tied to a system which is under critical examination in England and when there is this strong movement for a change. Obviously he seems to favour a State Bank or a Bank subject to political control in India

Fourthly, he is opposed to the vesting of the Governor-General with special responsibility for the financial stability and credit of the Federation The day-to-day management of the Reserve Bank should be the duty of the Board of Directors and of the high officers working under them The policy can only be laid down by legislation This legislation will be subject to the approval of the Governor-General under the new constitution But once it is so its practical application is to be the concern of the Reserve Bank and should not be the responsibility of the Governor-General

Further, he is opposed to the sale of any part of the silver now held in the Currency Reserves as even now the popularity of Currency Notes depends upon the belief of the people that they are convertible into rupees This first line of defence should be preserved unimpaired 'This is especially the case when the financial world is still disturbed, and time must be allowed for the Reserve Bank to command confidence in action ' The sales of surplus rupees will only command in sterling about one-third of their face value and the transaction would, therefore,

[5] The Secretary of State, in his reply No 8599, qualified the broad principle that the Reserve Bank should be free from any political influence by the words, 'so far as we can make it'

involve substantial losses, because the silver was bought for coining at prices much higher than prevailing now There may be an unexpected demand for coining rupees and as there is a movement for raising silver prices, just possible the Currency Authority may have to purchase silver at very high prices According to him, the Joint Select Committee should not leave the question of the sales of silver held in the Currency Reserves in India to the discretion of the Government of India

Gold Minimum Reserves

The whole of the present gold holding of Rs 44¼ crores should be earmarked as the minimum gold reserve against the Note issue He differs from the majority in this respect who lay down that Rs 35 crores should be the minimum and the Bank may do anything it likes with the excess of Rs 9¼ crores If the minimum figure of Rs 35 crores is accepted, he suggests an alternative that a percentage of not less than 15 per cent gold to the Note issue or Rs 35 crores should be laid down whichever is higher and he prefers the first alternative This he has recommended with a view to avoid the difficulty of requiring the Reserve Bank to buy gold at a premium should the currency recovery of the world be slow and difficult The most progressive countries have conserved their gold reserves by putting an embargo against gold export or increased them by purchasing gold at a premium, *i e*, above par of gold (85 shillings) even to the extent of 50 per cent There is a widespread feeling in India in favour of holding gold as affording ultimately the most reliable form of Currency Reserve

In paragraph 26 of their Report the Reserve Bank Committee recommend that "We approve generally of the provisions of Clause 41 of the 1928 Bill, relating to the suspension of reserve requirements and the connected tax provision We think it would be well to bring Clause 41 into a closer connection with Clause 31 in order to make it clear that the 'minimum' reserve can, and should, be utilized whenever this is called for by the circumstances" He dissents with this view and points out that if the minimum reserve can be utilized, it does not constitute a true reserve and the figures indicated in paragraph 24 of the Committee's Report have no significance then

The Rupee-Sterling Ratio

Sir Purushottamdas Thakurdas regards a suitable ratio as one of the essential factors for the successful working of the Reserve Bank He does not agree with the view of the Committee that the question of a suitable ratio for India should be left for consideration of the Government of India and discussion by the Legislature The suggestion of the Committee that

'the exchange obligations incorporated in the Bill must necessarily be in accord with the rupee sterling ratio existing when the Bill is introduced' is not acceptable to him. A review of the ratio is absolutely necessary before the inauguration of the Reserve Bank. He writes that 'No other Dominion or agricultural country has been able to maintain the pre-war parity of its internal currency at its original standard. Australia and New Zealand have depreciated their domestic currencies between 10 and 25 per cent while other agricultural countries have defaulted. The Indian ratio has been maintained at 1s. 6*d.* with considerable deflation of currency in India between 1925 and 1930 and with the fortuitous export of gold from India to the extent of more than £120 million since September 1931 to date.

'Every major country has either been at its pre-war parity for exchange or has been forced to go lower. India is the one country which is above it. Comprehensive measures have been taken in the U.S.A. to raise prices by the inflation of currency; further the executive has been armed with the power to devalue the dollar to the extent of 50 per cent. of its gold content. For India there is a strong and strengthening opinion that a lowering of the existing ratio of 1s. 6*d.* will give much relief to the cultivator. It is axiomatic that it will put less strain on the currency system of India should world conditions be slow in improving.'

The Reserve Bank Bill was referred after debate in the Assembly to a Select Committee. The trend of the debate showed that a majority of the elected members of the legislature favoured a State Bank to a Shareholders' Bank, or if the latter, they wanted the Bank to be absolutely free from political control in England and India. The Select Committee was expected to make certain modifications so that the Bank as Sir George Schuster in his speech on Thursday, the 14th September, 1933, said 'must become a trusted part of Indian public life' and that 'it must be an Indian institution commanding the confidence of Indian opinion, otherwise the whole purpose of this proposal would be lost.'

The first thing is that the Bank should be free from political influence not in India alone but in England also. The Bill as based on the recommendations of the London Committee would not be free from political influence in England is shown in his *Note of Dissent* by Sir Purushottamdas Thakurdas quoted above. Mr. G. P. Singh in the course of the debate in the Assembly on the Bill rightly pointed out that "political influence was not being eliminated because the Governor-General was representative of the largest political party and his powers would be exercised on behalf of the Secretary of State who was in the hands of the City of London." The Bank under

these circumstances could not be free from political influence in England and the Select Committee was expected to see that the British political influence also was eliminated

The Bill does not provide that the Governor and Deputy Governors and the majority of directors should be Indians. Under the scheme of 1928 Bill there would have been a majority of Indian directors, while under the present Bill even if the shareholders exercise their votes properly, Indians could only be half of the directors If the Bank is not to be free from British political influence and if a majority of Indians are not its directors, the *raison d'etre* of shareholders' bank is gone The Committee of the Federation of Indian Chambers of Commerce is of the opinion that a shareholders' bank might be acceptable, provided complete national control was assured and not less than three-fourths of the directors with voting power were natural born Indians and 75 per cent. of the paid-up capital was reserved for them Sir Purushottamdas Thakurdas whose view has been quoted above does not accept a shareholders' bank without qualifications [6]

STATE *Vs* SHAREHOLDERS' BANK

An analysis of the constitution of the Central Banks in other countries shows that there are purely shareholders' banks, State banks, and banks with mixed ownership as the following table will show[7] —

---

[6] Mr Manu Subedar points out in his *Minority Report* that by the Ruling of their Chairman the Indian Banking Committee were precluded from laying down the constitution of the Bank In this connection he writes "As the tenets of public procedure demand, I submit to this ruling and refrain from making any recommendations on the constitution of the Reserve Bank "

"The importance of decision on these matters may, however, be indicated The Reserve Bank is going to be the most powerful instrument affecting the economic life of this country Its errors and accomplishments will tell on the collective welfare of millions of people Its action will be unseen but not unfelt The layman would never be able to put at its door the consequences, which may have inevitably and certainly followed from its actions In the eyes of the world outside anything which the Reserve Bank of India will do, will be the index of the mind of India The Reserve Bank could cause tension and create animosities It is, therefore essential in India's interests, that the Reserve Bank should reflect in all respects the Indian nation, such as it is " *Minority Report of the Indian Banking Committee* p 296

[7] See *Present Day Banking in India* by Dr Ramachandra Rau, page 72 and *Central Banks*, by Messrs Kisch & Elkin, Chapter II Also see the Chapter on 'Central Banks' of my book "Currency and Commerce A Survey of Fundamental Principles and their Application to Indian Problems" for merits and demerits of Shareholders' and State Banks

Pure Shareholders' Central Bank	Pure State owned Central Bank	Mixed Ownership
The Austrian National Bank	The Commonwealth Bank of Australia	The National Bank of Czechoslovakia
The National Bank of Belgium	The National Bank of Bulgaria	The National Bank of Copenhagen
The Bank of England	The Bank of Esthonia	The Bank of Mexico
The Bank of France	The Bank of Finland	The Central Bank of Chile
The Reichsbank of Germany	The Bank of Latvia	The Bank of the Republic of Columbia
The National Bank of Hungary	The Bank of Poland	The Bank of Lithuania
The Bank of Italy	The State Bank of the R S F S R	The Federal Reserve Banks of the U S A
The Bank of Japan	The Swedish Riksbank	The Swiss National Bank
The Netherlands Bank		The Bank of Greece
The Norges Bank		The South African Reserve Bank
The Bank of Spain		The Bank of Albania

Merits of a Shareholders' Bank

(1) It can be free from political pressure if it is managed by competent businessmen and it can secure independence from the interference of the Executive in the day-to-day control of its business regarding its banking policy

(2) A shareholders' bank can work efficiently as it will be governed by motives of self-interest and "the State is too wooden and soulless to succeed in gauging accurately the monetary requirements of business people "

(3) The knowledge and experience of practical businessmen are likely to keep them on the right path and banking is a kind of trade in which the State should not take part

Demerits of a Shareholders' Bank

(1) Anybody can become a shareholder and will have a hand in shaping the policy of the bank which will deal with technical matters of currency, exchange and banking

(2) The control of the shareholders over directors is never real and in fact the shareholders themselves are under the control of directors and secretaries

(3) A private shareholders' bank will concentrate attention on making profits and in case of a Central Bank of Issue the policy of hankering after profits will defeat the objects with which such a bank is started In order to pay a dividend to the shareholders, the South African Reserve Bank had to perform additional functions For this very reason, the Irish Banking Commission disapproved of the idea of the private

shareholders' bank All the private shareholders' banks of issue except the Bank of England and the Reichsbank of Germany are under the rigid control of the State

(4) In poor countries, it may be unwise and uneconomical to pay a high rate of dividend derivable from the use of the currency reserves to the Bank's shareholders when capital can be easily borrowed by the Government at a low rate of interest

(5) The starting of a private shareholders' bank in countries where capital is not sufficiently developed will lead to a bid for ascendency in the practical management of the banking and financial system of the country, between the foreign and the indigenous capitalists Foreign influence should always be eliminated from the management and control of the Central Bank of Issue

(6) It is difficult to reconcile the idea of a privately owned bank with the State guarantee for its notes

(7) Such a Bank may not be sufficiently representative of all the interests in the country These arguments cannot be said to be very conclusive in favour of State ownership of the Banks of Issue and in practice Governmental interference in several ways can mitigate the evil effects of private ownership Arrangements can be made to eliminate foreign dominance by laying down that a majority of the directors should be the nationals of the country to which the Bank belongs The Government of the day can secure a wide representation of all interests in the country by reserving to itself the power of nominating a certain number of directors.

The Government can tone down the evil effects of the shareholders' Banks of Issue in the following ways —

(*a*) by limiting dividends to shareholders ,

(*b*) by allotting shares to small investors scattered all over the country ,

(*c*) by restricting voting power to "one man one vote";

(*d*) by the prevention of the right to vote by proxy ,

(*e*) by the prevention of manipulation of votes by big shareholders ,

(*f*) by limiting the functions of open market operations ,

(*g*) by enabling the State to participate in the Bank's profits

Arguments for a State-Owned Bank

(1) In India people look to the Government to lead any new movement and very great weight attaches to a Bank

founded upon the credit of the Government Even Ricardo advocated the creation of a State Bank for England in 1817

(2) The State Bank in India would do away with the quarrels on the part of the various banks for having a share capital in the Bank A State Bank would avoid the fear of control by foreign capitalists

(3) The Government keeps a very large sum of money every month with the Imperial Bank without interest which it can utilize to liquidate a portion of its debt or to reduce taxation if it acts as a Central Banker

(4) A private Central Bank can easily become subservient to the British commercial community which controls the Indian banking of to-day to a very great extent The main reason why Indians are so persistent in giving control to their Legislature is that the Indian Executive will have full control over the loan policy etc, of the Bank If the Executive is made responsible to the Legislature this insistence would not be demanded as it will cease to be necessary

Demerits of a State Bank

(1) The Bank may become a mere department of the Government and will reflect the opinion in its policy of the majority party in power which may be against the best interests of the country

(2) A State Bank can also be used for inflationary purposes by finance members to balance their budgets The Bank of Amsterdam was used for such purposes

(3) It is possible that public bodies might not get as much credit at the hands of the State Bank as from a Shareholders Bank In England there is a keen competition among banks for securing the accounts of various quasi-public bodies and if the State acquires control over the Bank they fear that they would receive less favoured treatment Many State Banks as in Russia, Bulgaria, etc have met with failures

(4) A State Bank may not be in a position to weed out the weak and inefficient banks by refusing to re-discount their commercial paper Incompetent banks may be nursed and well-managed commercial banks may not be developed

(5) It may not be able to train an adequate number of men who may be able to run banking institutions successfully This criticism is unwarranted and in India specially a Shareholders' Bank may not be able to do so as the Imperial Bank has not done, but a State Bank is the only institution in India which can be depended upon to achieve this object

Taking all these considerations into view it is a State Bank which is more suitable for Indian conditions but if a

Shareholders' Bank is started, very great care ought to be taken to free it from political control in England The State should have the right to purchase the shares of the Bank after a period of 15 years if it is found out that the Shareholders' Bank has not been able to rise to expectations A certain proportion of the capital must be reserved for people of Indian domicile and a certain percentage of directors must also belong to Indian domicile Shares should be of the face value of Rs 100 each and not of Rs 500 in order to prevent big capitalists from monopolizing shares and in order to secure a wide distribution of shares The Governor-General should not nominate the directors The utmost that the Select Committee should have agreed to was that the directors should be appointed by the Federal Government subject to the approval of the Governor-General

RELATIONS BETWEEN THE BANK AND OTHER BANKS

Preference should not be granted to the Imperial Bank It should be placed on the footing of other banks According to the scheme of Sir Basil Blackett of 1928 the Reserve Bank was to keep a sum of Rs 3 crores with the Imperial Bank free of interest The present restrictions upon the Imperial Bank are now to go and it will thus be able to compete with the other bankers in India with the help of their own money as they will be required to keep a certain minimum balance with the Reserve Bank This would be unfair to them The Reserve Bank should show some indulgence to these indigenous bankers It may discount the bills of member banks up to 50 per cent of the paid-up capital and reserves of a bank applying for accommodation In our country where banking habit is not well developed, the smallest rumour may cause a serious run on a bank A sympathetic handling of the situation by the Reserve Bank would thus be of the greatest importance Indian banks on the approved list should get re-discount facilities at 1 per cent below foreign banks In his editorial comments, the Editor of the *Indian Finance* wrote in this connection that "The term Bankers' Bank which is usually employed in reference to a Central Bank, though no doubt, useful as depicting the character of its normal working, tends to create a misapprehension that the ordinary banks are, and ought to be, the chief beneficiaries of the activity of the Reserve Bank Occasions might conceivably arise when the Reserve Bank will have to carry out a policy which is opposed to the narrow interests of the banks In India however, the immediate interest of the country lies in the spread of the banking habit through an expansion of the banking service to all parts of the country It is obvious that in securing this need, the Reserve Bank will have to take an active initiative, and

the most handy instruments are the indigenous joint-stock banks It is out of the question that the inducements necessary for banks to engage in this activity should be available to foreign institutions "[8]

As regards the agency business of the Reserve Bank there should be no favoured treatment of the Imperial Bank Tenders should be invited from banks on approved list for competitive terms and contracts for agency should be given after due consideration of all circumstances The Imperial Bank should not therefore, be the sole agent as mentioned in the Third Schedule of the Reserve Bank Bill The question of special concession to the Imperial Bank is proposed in the Bill does not arise if the Imperial Bank is not the sole agent

RECOMMENDATIONS OF THE JOINT COMMITTEE ON RESERVE BANK OF INDIA BILL

The Committee recommended a Shareholders' Bank by a majority

Constitution—The Central Board should consist of 15 Directors as below —

(*a*) A Governor and two Deputy Governors to be appointed by the Governor General in Council after considering the recommendations of the Board in that behalf The Committee accepted this proposal on the understanding that there must be prior consultation between the Governor General in Council and the Central Board before any recommendation is made

(*b*) Four Directors to be appointed by the Governor-General in Council The Committee were assured in this connection that this power would be used to ensure that territorial or economic interests "which have not secured adequate representation in the elections shall have such inadequacy corrected by this means , but we consider that in the instrument of instructions to the Governor-General a passage should be inserted making it clear that this power should be exercised in the general manner indicated above and in particular to secure adequate representation of the interests of agriculture and co operative banking if these interests had not secured such representation among the elected directors "

(*c*) Eight Directors to be elected by shareholders, *viz*, two for the Bombay register, two for the Calcutta register, two for the Delhi register, one for the Madras register, one for the Rangoon register and one Government official to be nominated by the Governor-General in Council The latter shall

[8] *Indian Finance*, dated September 9, 1933

not be entitled to vote The Nominated Directors should hold office for five years

There should be a Local Board for each of the five areas to consist of five members elected by the shareholders and three members to be nominated by the Central Board from amongst the shareholders on the register of that area In exercising the power of nomination, the Central Board "shall aim at securing the representation of territorial or economic interests not already represented" and particularly interests of agriculture and co-operative banks

No person should be appointed Governor of the Central Board unless he is a *person of tested banking experience* covering a period of not less than five years The Government members pointed out "that commercial banking experience is not necessarily an adequate qualification for the head of a Central Bank, and that recent experience of other countries affords many examples of extremely successful appointments of men who would have been excluded by the words of our *proviso*" Many members of the Committee wanted to add a provision that out of the three Directors, *viz*, the Governor and Deputy Governors, at least one should be an Indian This was waived when the official members in charge of the Bill were "prepared to give a definite assurance in the Legislature that the Government will take account of our representation and that it will be its policy in making the first appointments and thereafter that at least one of the three shall be a qualified Indian"

No person who has not some time been engaged in agricultural, commercial, financial or industrial activities may be a member of a Local Board Salaried Government officials or salaried officials of a State in India, persons who are insolvent or of unsound mind, an employee of a bank or director of a bank other than a co-operative bank will not be entitled to become members of a Local Board

Casual vacancies for the post of the Governor or a Deputy Governor of the Central Board shall be filled in by the Governor-General in Council after considering the recommendation of the Central Board

General Meetings of the Central Board —A general meeting shall be held annually at a place where there is an office of the Bank and two consecutive meetings shall not be held at the same place There shall be one vote for every five shares and voting by proxy may be exercised The maximum number of votes to be exercised by a person shall be ten

Share Capital —The original share capital is to be Rs 5 crores and the nominal value of the shares has been recommended to be reduced from Rs 500 to Rs 100 each Free

marketability of shares from one register to another is recommended "If, contrary to our expectations, it is found that one register is accumulating a large number of shares, while another is being denuded by a really substantial percentage, the Government should consider the question of bringing forward suitable amending legislation in order to rectify the position "

The nominal value of the shares originally assigned to the various registers shall be as follows —

Rs 140 lakhs to the Bombay register,
Rs 145 lakhs to the Calcutta register,
Rs 115 lakhs to the Delhi register,
Rs 70 lakhs to the Madras register, and
Rs 30 lakhs to the Rangoon register

Right of Discrimination —No person shall be registered a shareholder who is not—

(*a*) domiciled in India and an Indian subject of His Majesty or of an Indian State, or

(*b*) "A British subject ordinarily resident in India and domiciled in the United Kingdom or in any part of His Majesty's Dominions the Government of which does not discriminate in any way against Indian subjects of His Majesty" or

(*c*) "A company registered under the Indian Companies Act, 1913, or a society registered under the Co-operative Societies Act, 1912, or any other law for the time being in force in British India relating to co operative societies or a scheduled bank, or a corporation or company incorporated by or under an Act of Parliament or any law for the time being in force in any part of His Majesty's Dominions the Government of which does not discriminate in any way against Indian subjects of His Majesty, and having a branch in British India "

The Governor General in Council shall, by notification in the *Gazette of India*, specify the parts of His Majesty s Dominions which do not discriminate against Indian subjects of His Majesty

Clause 15 lays down that the first Governor and the first Deputy Governors shall be appointed by the Governor-General in Council on his own initiative and the first eight directors representing the shareholders shall also be nominated by the Governor-General in Council from the areas served respectively by the registers The non-official members of the Committee made it clear 'that they would not consider anything less than 75 per cent of the voting directors as affording a proper representation of Indians We have received an assurance on behalf of the Government from the Government members of the Committee that the Governor-General in Council will

exercise his powers so as to ensure the proper representation of Indians on the first Board "

BUSINESS WHICH THE BANK MAY TRANSACT

The Bank should do the following kinds of business —

(1) the accepting of money on deposit with interest from, and the collection of money for, the Secretary of State in Council, Local Governments, States in India, local authorities, banks and any other persons,

(2) (*a*) the purchase, sale and rediscount of bills of exchange and promissory notes, drawn on and payable in India and arising out of *bonafide* commercial or trade transactions, bearing two or more good signatures, one of which shall be that of a scheduled bank, and maturing within 90 days from the date of such purchase or discount,

(*b*) the purchase, sale and rediscount of bills of exchange and other commercial paper, which must be endorsed by a scheduled bank, and which is drawn to finance seasonal agricultural operations or the marketing of crops and maturing within nine months,

(*c*) the purchase, sale and rediscount of commercial paper bearing the signature of a scheduled bank and issued for the trading in the securities of the Government of India or a Local Government or of certain States maturing within 90 days,

(3) (*a*) "the purchase from and sale to scheduled banks of sterling in amounts of not less than the equivalent of one lakh of rupees",

(*b*) "the keeping of balances with banks in the United Kingdom", and

(*c*) "the purchase, sale and rediscount of bills of exchange (including treasury bills) drawn in or on any place in the United Kingdom and maturing within 90 days from the date of purchase provided that no such purchase, sale or rediscount shall be made in India except with a scheduled bank",

(4) making loans and advances for not more than 90 days to States in India, local authorities, scheduled banks and provincial co-operative banks on the security of stock, funds, gold or silver, bills of exchange and promissory notes eligible for purchase or rediscount by the Bank,

(5) the making of advances to the Governor-General in Council and to such Local Governments as may have the custody and management of their own provincial revenues, for a period of not more than three months from the date of the making of the advance,

(6) the issue of demand drafts made payable at its own offices or agencies

(7) the purchase and sale of Government securities of the United Kingdom maturing within ten years from the date of such purchase,

(8) the purchase and sale of securities of the Government of India or of a Local Government of any maturity, or securities of a local authority in British India or of an Indian State as may be specified by the Governor-General in Council on the recommendation of the Central Board

"Provided that securities fully guaranteed as to principal and interest by the Government of India, a Local Government, a local authority or a State in India shall be deemed to be securities of such government, or authority or State"

The amount of such securities in the Banking Department shall be regulated as below

(*a*) the value of such securities maturing after one year should not be more than the aggregate amount of the Bank's share capital reserve fund and three-fifths of the liabilities of the Banking Department in respect of deposits,

(*b*) the value of such securities maturing after one year shall not be more than the total of the share capital, reserve fund and two fifths of the liabilities of the Department in respect of deposits and

(*c*) the value of securities maturing after ten years is not to exceed the total of share capital, reserve fund and one fifth of liabilities of the Department in respect of deposits,

(9) the custody of moneys, *securities*, etc,

(10) the sale and realization of the property that may come into the possession of the Bank,

(11) the acting as agent for the Secretary of State in Council, the Governor-General in Council, any Local Government or local authority in connection with the following business —

(*a*) the purchase and sale of gold or silver, bills of exchange securities or shares in any company,
(*b*) the collection of proceeds by way of dividends, interest principal, etc,
(*c*) the remittance *of such* proceeds at the risk of the principal by bills of exchange,
(*d*) the management of *public* debt,

(12) the purchase and sale of gold coin and bullion,

(13) the opening of an account with or the making of an agency agreement with a bank which is the principal currency authority of any country,

(14) the borrowing of money for not more than one month for the business of the Bank from a scheduled bank in India and from an outside bank provided the latter is the principal currency authority in the country The total amount of such borrowing in India should not exceed the total capital,

(15) the making and issue of bank notes

OPEN MARKET OPERATIONS OR POWER OF DIRECT DISCOUNT

The Central Board or the Committee of the Central Board or the Governor, if, to the latter two, the power has been delegated, is of opinion that a special occasion has arisen making it necessary for the purpose of regulating credit in the interests of Indian trade, commerce, industry and agriculture, the Bank can do the following —

(*a*) purchase, sell or discount bills of exchange and promissory notes though the paper may not bear the signature of a scheduled bank or a provincial co-operative bank,

(*b*) make loans or advances repayable on demand or on the expiry of fixed periods not exceeding 90 days against certain forms of security as mentioned in Clause (4) of Section 17,

(*c*) purchase or sell sterling in amounts of not less than the equivalent of one lakh of rupees

"Provided that a Committee of the Board or the Governor shall not, save in cases of special urgency, authorise action without prior consultation with the Central Board and that in all cases action so authorized shall be reported to the members of the Central Board forthwith"

CENTRAL BANKING FUNCTIONS

(*a*) The Bank shall accept money for account of the Secretary of State in Council, Governor-General in Council, and Local Governments who have the management and custody of their own provincial revenues and make payments for them and shall do exchange, remittance and other banking business including the management of the public debt

(*b*) These authorities shall entrust the Bank with their money, remittance, exchange and banking business in India and shall deposit free of interest all their cash balances with the Bank

(*c*) The Bank shall be entrusted with the management of the public debt and with the issue of loans on conditions that may be agreed upon

"In the event of any failure to reach agreement on the conditions referred to, the Governor-General in Council shall

decide what the conditions shall be.' Such an agreement shall be laid before the Legislature.

(d) The Bank shall have the sole right to issue notes for a period to be determined by the Governor-General in Council on the recommendation of the Central Board. Such bank notes shall be legal tender throughout British India.

The Governor-General in Council shall supersede the Central Board and entrust the work to some other agency if the Bank fails to carry out its obligations.

Business not Allowed to the Bank

The Bank cannot—

(1) have a direct interest in any commercial undertaking except when it is necessary to satisfy its claim;

(2) purchase its own shares or of any other bank or company and cannot grant loans upon the security of any such shares;

(3) advance money on the security of immovable property;

(4) make loans or advances;

(5) draw or accept bills payable otherwise than on demand;

(6) allow interest on deposits or current accounts.

Assets of the Issue Department

(1) The assets shall consist of gold coin, gold bullion, sterling securities, rupee coin and rupee securities whose value will not be less than the total of the liabilities.

(2) The value of gold coin, gold bullion and sterling securities is not to be less than two-fifths of the value of the assets.

(3) The amount of gold coin and gold bullion is not to be less than forty crores of rupees in value. The London Committee had fixed it at 35 crores.

(4) The remaining assets shall be in rupee coin, rupee securities of the Indian Government, bills of exchange and promissory notes payable in British India as are eligible for purchase by the Bank.

(5) The amount of Government of India rupee securities shall not exceed one-fourth of the total amount of the assets or fifty crores of rupees whichever amount is greater, or, with the previous sanction of the Governor-General in Council, such amount *plus* a sum of rupees ten crores.

(6) Gold coin and bullion shall be valued at 8.47512 grains of fine gold per rupee, rupee coin at its face value and securities at their market value.

(7) Not less than seventeen-twentieths of the gold coin and bullion shall be held in British India

(8) The sterling securities shall be of the following kinds payable in the currency of the United Kingdom, namely,

(a) balances at the credit of the Issue Department with the Bank of England,

(b) bills of exchange having a maturity not exceeding 90 days payable at any place in the United Kingdom,

(c) Government securities of the United Kingdom maturing within five years

LIABILITIES OF THE ISSUE DEPARTMENT

The liabilities of the Issue Department shall be equal to the value of the currency notes of the Government of India and Bank Notes for the time being in circulation The Issue Department is to take over from the Governor-General in Council the liability for all the currency notes of the Indian Government under circulation In exchange, gold coin, gold bullion, sterling securities, rupee coin and rupee securities shall be transferred to the Issue Department equal in value to the total amount of the liability The total of gold coin, gold bullion and sterling securities transferred shall not be less than 50 per cent of the whole amount transferred and the amount of rupee coin shall not exceed 50 crores

"Provided further that the whole of the gold coin and gold bullion held by the Governor-General in Council in the Gold Standard Reserve and the Paper Currency Reserve at the time of transfer shall be so transferred "

If the amount of the rupee coin is greater than 50 crores of rupees or one-sixth of the total amount of the assets, as shown in the weekly accounts, whichever is greater, "the Bank may deliver to the Governor-General in Council rupee coin up to the amount of such excess but not without his consent exceeding five crores of rupees, against payment of legal tender value in the form of Bank Notes, gold or securities " If it is less than 50 crores or one-sixth of the total value of the assets, whichever may be greater, the Governor-General in Council shall deliver to the Bank rupee coin up to the amount of such deficiency, but not without his consent exceeding five crores of rupees, against payment of legal tender value

RATIO

Clauses 40 and 41 have been recommended to remain as they are, *i e*, the Bank shall have the obligation to sell sterling for immediate delivery in London at a rate not below 1*s* $5\frac{19}{64}$*d*

per rupee and to buy sterling at a rate not higher than 1s 6 3/16d per rupee Provided that no person shall be entitled to receive payment unless the Bank is satisfied that the payment of sterling in London has been made "

RELATIONS WITH SCHEDULED BANKS

The number of banks included in the second schedule is 27 and the daily balance shall not be below 5 per cent of the demand liabilities and two per cent of the time liabilities Liabilities will not include the paid up capital the reserves or any credit balance in the profit and loss account of the Bank or the loans borrowed from the Bank

If the balance is below the minimum prescribed, the scheduled bank will pay to the Reserve Bank for each such day penal interest at 3 per cent above the Bank Rate on the amount by which the balance at the Reserve Bank is less than the minimum prescribed and if on the day of the next return the balance is still below the prescribed minimum the rates of penal interest shall be increased to 5 per cent above the Bank Rate for each subsequent day

The Governor General in Council shall direct the inclusion of a bank in the list of scheduled banks if its paid-up capital and reserves is not less than five lakhs of rupees and can exclude a bank from such list if its paid-up capital falls below rupees five lakhs

AGREEMENT WITH THE IMPERIAL BANK

(a) The Reserve Bank should enter into an agreement with the Imperial Bank for a period of 15 years and thereafter until terminated after five years notice on either side

(b) The agreement shall be conditional on the maintenance of a sound financial position by the Imperial Bank and if either the conditions of the agreement are broken by the Imperial Bank or it fails to maintain a sound financial position the Governor-General in Council on the recommendation of the Central Board can issue instructions to the Imperial Bank and if they are disregarded, the agreement may be terminated

The terms of the agreement as laid down in the Third Schedule are to be as below —

(1) The Imperial Bank of India shall be the sole agent of the Reserve Bank of India at all places in British India where the Imperial Bank has a branch which was in existence at the commencement of the Reserve Bank of India Act 1933, and there is no branch of the Banking Department of the Reserve Bank of India

(2) The Reserve Bank in consideration of this service rendered shall pay to the Imperial Bank of India as remuneration a sum which shall be for the first ten years during which this agreement is in force a commission calculated at one-sixteenth of one per cent on the first 250 crores and one-thirty-second of one per cent on the remainder of the total of the receipts and disbursements dealt with annually on account of Government by the Imperial Bank of India on behalf of the Reserve Bank of India The remuneration shall be revised after 10 years and the remuneration for the ensuing five years shall be determined on the basis of the actual cost to the Imperial Bank of India At the end of each quinquennial the remuneration shall be subject to revision during the life of the agreement In case of dispute regarding the said remuneration, the decision of the Governor-General in Council shall be final He may require the Imperial Bank to furnish such information as he thinks fit

(3) In consideration of the maintenance by the Imperial Bank of India of branches not less in number than those existing at the commencement of the Reserve Bank of India Act, 1933, the Reserve Bank shall, until the expiry of fifteen years from the coming into force of this agreement make to the Imperial Bank of India the following payments

(*a*) nine lakhs of rupees annually during the first five years,

(*b*) six lakhs of rupees annually during the next five years, and

(*c*) four lakhs of rupees per annum during the next five years

(4) Without the approval of the Reserve Bank of India, the Imperial Bank of India shall not open any branch in substitution for a branch existing at the time this agreement comes into force

POWER TO OPEN A BRANCH IN LONDON

In this connection the Committee write, "We considered in this connection whether it would be proper to place a statutory obligation on the Reserve Bank to open a branch in London We have noted that the present tendency among the Central Banks of the world is not to establish branches outside their own countries but to employ other Central Banks as their agents at foreign centres While we should be unwilling to make any recommendation which could be construed as a failure to appreciate the importance of international co-operation between the Central Banks of various countries, we cannot accept the view that the practice of other countries affords an exact parallel to the particular case of India as regards

and the Central Banking Enquiry Committee also started on the assumption that it would be a State Bank. A Shareholders' Bank does not secure freedom from political influence, because the Bill does not seek to remove the influence of the Secretary of State who represents politics as much as the future Indian Minister and hence it does not secure the freedom from political influence which the Government claims. In either case the Secretary of State will have determining voice, but in case of a Shareholders' Bank, he will be immune from the criticisms of the Indian public and of Legislature.

(2) Several countries of the world, notably Australia and Sweden, have State Central Banks. The future trend of the monetary policy and the working of Central Banks cannot be predicted, but the theory of Central Banking is in the melting pot, and the other countries may have to follow America in the Government taking active and effective part in the control of their monetary policy. "Consequently the argument in regard to the example of other countries has not much force until the conditions of the world are settled down and we know the nature and significance of the profound changes that are taking place. Even in England, the Conservative Government are finding it necessary to effect changes in the administration of the Bank of England with a view to allow greater voice for the Treasury." (Page 16 of the *Report*.)

The arguments for a State Bank are summarised by them as follows:—

(1) In times of crisis the Government assumes entire responsibility of the administration of Central Banks. The Central Bank functions smoothly only in normal times and for such times shareholders are as much unnecessary as the State. It is the Governor of the Bank that counts.

(2) The State Bank will always command a greater confidence of the public than a Shareholders' Bank in a country like India.

(3) Almost entirely the profit will be derived from State support, and it is therefore desirable that the tax-payers should get the utmost benefit of the profits.

(4) Shareholders do not form a satisfactory electorate as those who live at a great distance seldom come to attend meetings.

(5) In the case of a private Bank there will be no machinery to demand and enforce larger recruitment of Indians in the officers and subordinate grades. It is only in the case of a State Bank that the policy of Indianization can be effectively pursued.

The dissentients point out that if their scheme of a State Bank is not accepted, the following changes should be introduced in the Shareholders' Bank scheme —

(a) 75 per cent of the Directors or members of the Local Boards must be native Indian subjects of His Majesty This condition was accepted by the External Capital Committee

(b) The Reserve Bank should establish its own branch in London, which should hold entirely the foreign balances and reserves of the Government of India Mr Basu and Mr Ram Saran Das disagree to this

Reserve

Regarding the amount of Reserve and the nature of external Reserve three important factors should be considered

1 Paper notes in circulation amounting to Rs 180 crores.

2 The silver rupees in circulation which are notes printed on silver

3 Annual external obligations roughly amounting to 70 crores of rupees

In view of these factors, it is suggested that the external reserve should be sixty per cent of the liabilities in place of 50 per cent as proposed in the Bill The Hilton-Young Commission had recommended the Reserve to be Rs 118 crores

As there is to be an obligation on the Imperial Bank to offer free remittance to the scheduled banks from currency chests, it is suggested that the latter in turn should make inter-branch transfers for their constituents free of charge

To give impetus to branch banking the Reserve Bank should maintain a list of approved banks They should be banks registered in India and should satisfy some minimum criteria regarding the capital and balance-sheet Any such bank opening a branch in a place where there is no branch of a scheduled bank, should be entitled to an interest-free deposit of Rs 3,00 000 from the Reserve Bank for the first two years and Rs 2,00,000 for the next two years

Ratio

They do not regard the ratio question outside the province of the Reserve Bank Bill The Reserve Bank will be responsible for maintaining the exchange within prescribed limits This is particularly important in the case of India as she has large remittances to make

"This fact is being fully appreciated in devising the plan for a Reserve Bank for New Zealand Since England went off gold standard, New Zealand pound has depreciated by 10 per cent But in planning the scheme of the Reserve Bank,

the authorities realized that in view of the Bank having to fulfil the external obligations of the country, the depreciation of 10 per cent was not enough It has now been decided to have a further lowering of the ratio by another 10 per cent In the same way, the ratio is, we are convinced, part and parcel of the proposal to establish the Reserve Bank of India "

"In our opinion the 18*d* ratio has done great harm to the country The gravity of the harm done can be realized from the fact that India, which enjoyed, almost uninterruptedly, a favourable balance of trade in merchandise to the extent of about Rs 80 crores per annum, had only a merchandise surplus of Rs 3,38 crores in 1932-33 "

"Out of the normal surplus, India was finding it possible to meet her recurring external obligations and also to import treasure for the requirements of the population Our foreign commitments are now being met by the export of 'distress gold' This export cannot continue for long Unless adequate measures are adopted to restore the favourable balance of trade in merchandise to the level of our foreign commitments, the Reserve Bank will be faced with an embarrassing situation right at the commencement as soon as the exports of gold cease or fall off "

"We are definitely of the opinion that in view of the successful way in which countries like New Zealand and Australia have brought about favourable balances of trade by depreciating their currencies, India, too, should lower her ratio before inauguration of the Reserve Bank " Since September 1931, pound sterling has been allowed to depreciate to such an extent as the British Monetary authorities regard suitable in relation to their economic conditions When the rupee is linked to sterling, it is assumed that economic conditions are the same in England and India If this were so the movements in the Index of wholesale prices in India should correspond to the movements in the Index in the United Kingdom Really it is not so In the United Kingdom the Index of wholesale prices has gone up by 3½ points between September 1931 and August 1933 In the case of India, it has gone down by 3 points during the same period This difference of 6½ points between the level of prices in the two countries conclusively shows that the rupee is over-valued In view of these facts, the lowering of the ratio is regarded as the first step in raising the level of prices

Right to Amend the Reserve Bank of India Act

In one of the *Notes of Dissent* by Mr Sant Singh, a case is made out for the fact that the Indian Legislature should have the right to amend in future the Reserve Bank Act "We consider this right to be of such a fundamental character as

to make the details of the Bill much less important If the Indian Legislature of the future is denied the right to take such matters into consideration as may be approved of or permitted by the Governor-General on the advice of his Ministers the Reserve Bank will be fettered in laying down the Currency and Exchange policy of India Unless the matter is cleared up to our satisfaction it will be our duty to advise the Legislature not to proceed with the consideration of the Reserve Bank Bill ' (Extract from the Statement handed over to the Chairman by twelve members of the Joint Committee on Reserve Bank of India Bill quoted in the *Minute of Dissent*, page 20)

AMENDMENTS MADE BY THE INDIAN LEGISLATURE

The Indian Legislative Assembly passed the following amendments to the Reserve Bank of India Bill —

(1) "No person who having been duly registered as a shareholder ceases to be qualified to be so registered shall be able to exercise any of the rights of a shareholder otherwise than for the purpose of sale of his shares "

(2) The share capital of the Bank can be increased or decreased on the recommendation of the Central Board with the previous sanction of the Governor-General in Council and with the approval of the Central Legislature to such an extent and in such a manner as may be determined by the Bank in a general meeting

(3) The proposal for the compulsory establishment of the London Branch was carried It would thus be obligatory on the Central Board to open a branch of the Bank in London at the commencement of its operations in India The following arguments were advanced in favour of the proposal —

(*a*) The London Branch would provide valuable opportunities to Indians to get training in banking and to come into contact with international banking experts

(*b*) The London Branch would do more economically the work in connection with Home Charges and other operations of the Reserve Bank

(*c*) It would cause a great saving in commission and other charges which India would otherwise be paying to England

(*d*) The absence of the London Branch might involve dictation by the Bank of England In this connection the Government of India's Despatch to the Secretary of State was quoted in which it was stated that the Reserve Bank Branch in London should work on lines approved of by the Bank of England

The following arguments were advanced against the proposal —

(*a*) The progress in India could best be made by international co-operation

(*b*) It would create suspicion in London and lead to undesirable repercussions

(*c*) The Bank of England would be prepared to give much better facilities for training Indians than could be provided by the London Branch of the Reserve Bank

(*d*) A branch of the South African Reserve Bank was not considered fit to be opened in London though South Africa had an enormous business to transact in the international financial centre The proposal for the London Branch was carried

(4) The Bill as emerged from the Joint Committee contained a clause to the effect that the Governor of the Reserve Bank should be a person possessing tested banking experience of not less than five years This clause was proposed to be deleted and the amendment was carried It was pointed out in favour of the clause that the words "tested banking experience" found place in the legislation recommended by the Macmillan Committee for the Canadian Central Bank and that the South African Act went a step further in this respect by stipulating that the Governor should be a resident of South Africa The motion for the deletion of the clause was passed

Amendments were also moved to lower the ratio and a spirited debate took place in this connection The protagonists of the lower ratio, or of a change in the ratio, pointed out that India's gold resources had been depleted, her balance of trade had been considerably reduced and it had increased the burden of rent and land revenue by lowering the prices of primary commodities A change in the ratio was consequently necessary to provide relief to agriculturists The arguments advanced against a change in the ratio were that it would increase the burden of Home Charges and consequently higher taxation would be necessary The lower ratio would be beneficial only to middlemen and cultivators would not gain and it would be against the best interests of the workers Sir George Schuster referring to the ratio quoted the language of the London Committee's Report that provisions in the Bill were designed to make clear that there would not be any change in the *de facto* situation by the mere coming into operation of the Reserve Bank Act The Finance Member added that "Government takes a stand on that Report We cannot regard the ratio as arising on this Bill at all If we had thought that our introduction of the measure would be made an occasion

for attempting to revise the present ratio position we should never have introduced the Bill The question which I have to ask the Legislature is whether they want the Reserve Bank and not whether they want the present ratio We do not seek to get any new confirmation of that from the Legislature That already has a statutory force and we don t seek or need to strengthen it ' The Assembly endorsed the provision of the Bill regarding the ratio and negatived the amendments thereto

Criticism of the Scheme

The Reserve Bank Scheme as embodied in the Reserve Bank Bill is open to criticism in the following respects —

(1) One of the fundamental provisions of the Charters of Central Banks all over the world is that every shareholder must be a person belonging to the nationality of that country and even if non-nationals are allowed in some cases to become shareholders they are not allowed to vote at general meetings. This fundamental point was conceded by Sir Basil Blackett in 1928

(2) The power of nominating directors should not have been vested in the Governor-General but should rest with the Federal Minister of Finance subject to the approval of the Governor-General, if necessary

(3) The maintenance of the existing ratio intact is obviously disadvantageous from the point of view of India

(4) It should have been made obligatory upon the Government to undertake the purchase of gold and to stop gold exports This is what other countries have been doing in case of necessity

(5) The preferential advantages given to the Imperial Bank are unnecessary

CHAPTER XVIII

Indian Currency and Exchange

IN northern India since the time of Akbar, currency had come to consist of the gold Mohur and the silver rupee and both weighed 175 grains troy In southern India gold was the principal currency as under the Hindu rule preference was given to the yellow metal After the downfall of the Moghal Empire a very large number of small independent states sprang up which signalized their independence by adopting special coins of their own When the English East India Company came into power in India, a very large number of gold and silver coins were in circulation in the country without any relation to one another[1] The result was that the services of appraisers became indispensable to ascertain the value of coins The trade of the Company was greatly hampered by this state of the Indian currency system Thus a series of experiments began in the currency system of India

The history of Indian currency in the 19th century can be divided into four periods[2] —

(1) In the *first period* from 1801 to 1835 attempts were made by the Company to adopt a uniform rupee for their own territory Both gold and silver coins were simultaneously issued with the stamp of the Company with a definite legal ratio and weight and fineness Owing to the fluctuations in market prices of the two metals, it was found impossible to maintain the legal ratio In 1818, the silver rupee of 180 grains, 11/12th fine was substituted for the gold pagoda in the Madras Presidency Though the coinage of the latter was stopped, gold coins could be issued to suit the convenience of the public and they were to be received and paid at all the public offices at such rates as were to be determined from time to time In 1823 the Bombay rupee was made identical with the Madras rupee and in 1835 the Indian rupee in its present form and weight was issued which was identical with the Madras rupee of 1818 It was made legal tender throughout the Company's possessions and mints were opened to its free coinage The Indian currency system thus became the silver standard in 1835 and remained so till 1893

(2) In the *second period* from 1835 to 1874 attempts were made to introduce the gold standard, but in the latter year the proposal was definitely rejected by the Government

---

[1] Macleod, *Indian Currency*, p 13

[2] Findlay Shirras, *Indian Finance and Banking*, p 93

of India The Government issued a Proclamation in 1835 authorizing the public treasuries to receive freely the gold *mohurs* at their face value at the rate of 15 1 Owing to the discoveries of gold in 1848 and 1849, gold depreciated in terms of silver It became cheap in the market as compared with its mint ratio People began to make payments in gold and the Government had to withdraw their Proclamation of 1841 After 1850 the production of silver did not keep pace with its demand and there was a great scarcity of money in the market A demand grew up among businessmen for a gold currency and in 1864 the Government issued a Notification by which sovereigns and half sovereigns were to be received at Government Treasuries at Rs 10 and Rs 5 respectively The Mansfield Commission in 1866 recommended that gold coins of the face value of 15, 10 and 5 rupees should be issued and that the currency should consist of gold, silver and paper The Government did not take any action on the report of the Commission By a Notification in 1868 the Government raised the rate for the receipt of sovereigns and half sovereigns to Rs 10-4 and Rs 5-2 respectively The Government thus showed their ultimate desire for a gold currency In 1872 Sir Richard Temple suggested a gold standard and currency and urged the appointment of a Commission, but in 1874 the Government decided not to accept the proposal.

(3) The *third period* from 1878 to 1893 ends with the appointment of the Herschell Committee During this period the price of silver was falling and that of gold was rising very much With the depreciation of silver the gold value of the rupee was falling heavily so much so that exchange fell from 2*s*. gold in 1871 to about 1*s* 2*d* in 1892 The white metal was being imported in large quantities and heavy coinage sent up prices in India a good deal From 1874 to 1878 there was an agitation in India for closing the mints to the free coinage of silver with a view ultimately to the adoption of the gold standard In the latter year the Government themselves made a proposal to the Secretary of State for a gold standard for India, but the British Treasury to whom the matter was referred advised that "it was better to sit still than to have recourse, under the influence of panic, to crude legislation the result of which cannot be foretold and the effect of which cannot be measured" India consequently supported bimetallism, but the scheme fell through as England was opposed to the system

(4) In the *fourth period* from 1893-1898 the value of silver continued to fall and the American Government repealed the Shermon Act according to which they were purchasing 54 million ounces of silver for annual coinage This made the position of the Indian rupee more precarious than ever before and

in 1891 the Government of India again approached the Secretary of State with a proposal to close the Indian mints to the free coinage of silver in order eventually to introduce the gold standard if the Brussels Conference which was then sitting did not succeed The Herschell Committee to whom the proposal was referred for investigation and report, approved of the proposals of the Government of India with certain modifications They recommended a sort of limping standard under which there was to be no free coinage of gold or of silver The rupee was to continue to remain full legal tender and gold was to be used only partially for currency purposes during the period of transition, at the end of which steps were to be taken to introduce gold standard

The recommendations of the Committee were accepted by Her Majesty's Government and in 1893 an Act was passed to amend the Coinage Act of 1870 and the Indian Paper Currency Act of 1882 Indian mints were to be immediately closed to the free coinage of silver, but the Government retained power to coin rupees on their own account On the 26th of June 1893 three Notifications were issued, whereby arrangements were made for —

(1) the receipt of gold at the rate of 7 53344 grains of fine gold per rupee

(2) the acceptance of sovereigns at Rs 15, and

(3) the issue of currency notes in exchange for sovereigns or gold bullion

The objects were to arrest the fall in the exchange value of the rupee, to encourage the import of foreign capital, to familiarise the people with the use of the gold sovereign and finally, to discourage the imports of silver The intention was ultimately to introduce gold standard to link India immediately with gold standard countries, but a period of transition was regarded as necessary before the actual introduction of the gold standard

In 1898 the Fowler Committee was appointed to consider and report on "The proposals of the Government of India for making effective the policy adopted by Her Majesty's Government in 1893 and initiated in June of that year by the closing of the Indian mints to what is known as the free coinage of silver That policy had for its declared object the establishment of a gold standard for India"[3]

Proposals before the Fowler Committee

The Committee considered a number of proposals, and the following were the chief among them —

[3] *Fowler Committee Report* para 1

(a) *That of the Government of India*.—The Government of India proposed that money should be borrowed in England and a portion of it should be remitted to India in the form of gold to serve as the basis of gold reserve. In order to raise the gold value of the rupee to 1s. 4d. a certain number of rupees were to be melted after being withdrawn from circulation. The silver bullion so obtained was to be sold for gold which was to be added to the reserve and the Government were not to part with any gold in their possession until the exchange value of the rupee had come up to 1s. 4d. Till that time gold was not to be made legal tender though that was to be the ultimate goal of the currency policy. The Fowler Committee did not agree with the view of the Government that "the rise in the exchange value of the rupee was entirely due to the contraction of currency," and held that "the forces which affect the gold value of the rupee are complicated and obscure in their operation."[1] They did not recommend, therefore, the drastic action of further contracting the currency as such action was likely in their opinion to accentuate the stringency in the Indian money market and provoke the opposition of the business community in India.

(b) *The Lindsay Scheme*.—Lindsay was the Deputy Secretary and Treasurer of the Bank of Bengal and his scheme though rejected by the Fowler Committee closely resembled the plan adopted afterwards. Its essence was to make the rupee the circulating medium in India and gold was not to be made legal tender. According to the scheme a long period loan of £ 10 million was to be raised in London to be kept there as Gold Standard Reserve. Sterling drafts were to be drawn on London in India for not less than £1,000 at the rate of 1s. 3¾d. to the rupee and were to be met from the Gold Standard Reserve. This was designed to prevent a fall in the value of the rupee below 1s. 4d.

In London rupee drafts were to be sold for not less than Rs. 15,000 at 1s. 4 1/16d. to the rupee and were to be paid at Calcutta and Bombay. If, as a result of selling sterling drafts in India, there was an excessive accumulation of rupees here and undue depletion of the gold reserve in London, the excess

[1] The main causes of the rise in the value of the rupee were:—

(a) the contraction of currency due to the closing of the mints to the free coinage of silver;

(b) the increase in the demand for money because of the expansion in trade, railway development and irrigation works, etc.;

(c) the snapping of the link between the rupee coin and the metal silver of which it was made, making it possible for the former to rise in value while the latter was depreciating.

of rupees was to be sold as bullion and the proceeds were to be credited to the Gold Standard Reserve in London In case the stock of rupees was not adequate to meet rupee drafts in India, silver was to be purchased out of the Gold Standard Reserve in London to be coined into rupees in India They rejected the scheme for two reasons Firstly, it would check the flow of foreign capital into India but foreign capital was very necessary to develop Indian economic resources and secondly, if made permanent, the plan would base India's gold standard for all time on the gold reserve in London amounting to a few million pounds sterling There would be a liability to pay gold in London for rupees tendered in India to an unlimited extent

(c) *Silver Monometallism*—The Committee rejected the plan because it had no advocates left now and persons like Sir James Westland who in 1886 had vehemently opposed the closing of the mints to the free coinage of silver were strict opponents thereof in 1898[5] The case for its restoration was rendered very weak by its actual discontinuance since 1893

RECOMMENDATIONS OF THE FOWLER COMMITTEE

The Fowler Committee "Looking forward to the effective establishment in India of a gold standard and currency based on the principles of the free inflow and outflow of gold," recommended the following measures[6] —

(1) The Indian mints should continue closed to the unrestricted coinage of silver and should be opened to the unrestricted coinage of gold,

(2) the sovereign should be made a current coin and legal tender,

(3) the ratio between the rupee and the pound sterling should be Rs 15 to the £ *i e*, the exchange value of the rupee should be 1s 4d ,

(4) no legal obligation to give gold for rupees for merely internal purposes should be accepted , but

(5) the net profit on the coinage of rupees should be held in gold as a special reserve and made freely available for foreign remittances whenever exchange fell below gold specie point ,

(6) the Government should continue to give rupees for gold, but fresh rupees should not be coined until the proportion of gold in the currency was found to exceed the requirements of the public

The Committee thus accepted as their model the limping standard adopted by the Latin Union and the United States

[5] See Kale, Vol II, Seventh Edition, pp 198-99
[6] *Fowler Committee Report*, para 54

under which both gold and silver were unlimited legal tender with a fixed legal ratio but mints were thrown open to the free coinage of gold alone

These recommendations were accepted without qualification by the Secretary of State who on the 25th of July 1899 requested the Government of India to make preparation for the coinage of gold

(1) GOLD CURRENCY

Negotiations were set on foot for starting a gold mint in India but they proved fruitless because of the opposition of the British Treasury who asked the Secretary of State to reconsider the whole question and said ' that sovereigns were being readily attracted to India whenever required, and that there was no reason for believing that the position of the gold standard in India would be strengthened, or public confidence in the intentions of the Government of India confirmed, by the mere provision of machinery for the manufacture of gold coins in the country They further pointed out the practical difficulties in the way of the establishment of a branch of the Royal Mint in India, an arrangement which they described as anomalous, and likely in practice to give rise to inconvenience and possible friction ' The Government gave up the scheme in the absence of an assurance that a regular supply of gold would be available for minting as the chief Indian mining companies had made arrangements for the regular sale of their gold outside the country and were not likely to alter those arrangements at an early date

In 1900 the Government made an attempt to issue sovereigns in circulation and instructed the railways and other government bodies to receive and pay sovereigns for their transactions This was famine time and the attempt failed because of the low purchasing power of people then prevailing throughout India when the sovereign was unsuitable

In 1909 the Government of India applied to the Secretary of State for a holding of about £ 9 million liquid gold in the Paper Currency Reserve, in order to make a gold currency possible and they pointed out that the popularity of the sovereign was rapidly increasing till checked by the crisis of 1907-08 and that sovereigns were actually changing hands at a premium even in the chief commercial centres of the country, while for ordinary purposes they were practically unobtainable The Secretary of State rejected the suggestion on the ground that they might cause the periodical recurrence of a stringency in the London money market

In 1912 the Government of India again urged the opening of a branch of the Royal Mint in India and the Secretary of State got into touch with the Treasury and replied that if th

two alternatives suggested by the Treasury "are dismissed, it will remain to consider whether it is desirable to produce at one of the Indian Mints a separate Indian gold coin of the denomination of, say, Rs 10, this course would be inexpensive and would avoid the interference of the British authorities in your general coinage operations" and that he would be prepared to sanction the issue of such a coin

The Government of India accepted the proposal of the Secretary of State and requested him to sanction the scheme The latter informed them suggesting that the usual procedure for eliciting public opinion in India should be followed before any final decision was taken and later on he wrote that the question of gold coinage should be left to be investigated by the Chamberlain Commission

During the War the Bombay Mint was made a branch of the Royal Mint for the coinage of sovereigns for a short period The Babington Smith Committee in Paragraphs 66 and 67 of their Report recommended that "the Branch of the Royal Mint which was opened in Bombay during the War for the coinage of sovereigns and half-sovereigns and has since been temporarily closed, should be reopened, and that arrangements similar to those in force in the United Kingdom should be made for the receipt of gold bullion for the public for coinage The Government of India should announce its readiness to receive gold bullion from the public, whether refined or not, and to issue gold coin in exchange at the rate of one sovereign for 113 0016 grains of fine gold, subject to a small coinage charge"

In January 1922 the Finance Member in the Legislative Assembly speaking on the Resolution of Sir Vithaldas Thackersay on currency and exchange gave a guarantee for opening Indian Mints to the free coinage of gold when he said, 'He is well aware, Sir, that it was a cardinal feature in the policy of the Babington Smith Committee that the Indian Mints should be opened to the free coinage of gold Indeed, one of the intentions of the Committee in fixing the rupee on a gold basis was to permit of the free use of gold currency in India, and the opening of the Mints to the free coinage of gold is an aid to such a process, though of course it is not in itself an essential condition of it" In short, this is the history of the various attempts made by the Indian Government and the public to get a Mint for gold opened in India as recommended by the Fowler Committee

(ii) GOLD STANDARD RESERVE

Another important recommendation of the Fowler Committee was that "any profit on the coinage of rupees should not be credited to the revenue or held as a portion of the ordinary balance of the Government of India, but should be kept

in gold as a special reserve, entirely apart from the Paper Currency Reserve and the ordinary Treasury balances "[7]

The way in which the departure was made from this recommendation is described below

In September 1900, the Government proposed to inaugurate this special reserve of gold The profits of coinage for the preceding year—for it was in 1899 that rupee coinage was for the first time undertaken after 1893—amounting to £1 million were not available temporarily as they had been used to meet the pressing famine demands

The Viceroy and the Finance Member in 1909 disagreed on the policy to be adopted with regard to the gold holding in the Paper Currency Reserve and referred the matter to the Secretary of State who gave a decision regarding the Gold Standard Reserve and not regarding the actual holding of gold in the Paper Currency Reserve, a matter which was referred to him

In 1907 in response to the recommendations of the Mackay Committee, the Secretary of State decided that £1 million out of the profits on coinage might safely be diverted from the Reserve to be utilized on railway capital expenditure This was contrary to the recommendations of the Fowler Committee and against the wishes of the Indian commercial community who were not consulted on the point[8] Later on it was decided that half the profits on coinage should be spent on railway capital expenditure

In 1908 the Secretary of State telegraphed to the Government that the balance of the Gold Standard Reserve would be lent on security *on short temporary loans* The Government of India represented to the Secretary of State on the following points in connection with the Gold Standard Reserve in 1909 —

Firstly the whole of the profits on coinage should be devoted to the Gold Standard Reserve and should be held in a liquid form and that any failure to fulfil the "definite pledge of our active support of the Gold Standard either through the exhaustion of the Reserve or for other cause would shake the public confidence in our currency policy to a degree which it would be difficult to estimate " (Para 2 of the Government of India's Despatch No 89 of the 1st April, 1909 quoted by Sir Purushottamdas Thakurdas in his *Minute of Dissent to the Hilton-Young Commission Report*) They pointed out that it was the intention of Lord Curzon's Government to

[7] *Fowler Committee Report*, para 60

[8] *Minute of Dissent* of Sir Purushottamdas Thakurdas to the Report of the Royal Commission on Indian Currency and Finance, para 23, p 109

keep the reserve in liquid gold in India and that other countries were careful to retain the ultimate foundation of their credit in bullion and that their strength in combating a low exchange depended on their ability to reduce the supply of rupees and to simultaneously augment the supply of gold. "At present we can only reduce the supply of rupees, for our gold has already been put on the market, and all that is meant by realizing it is the transfer of certain securities from Government to another holder." They also referred to the huge loss of about £15 million gold which took place between 1907 and 1909 as a result of large sales of securities whose prices fell very much.

Secondly, they requested him to reconsider his decision of utilizing half the profits on coinage for capital expenditure on railways and urged upon him the necessity of allowing the future profits on coinage to pass into the Gold Standard Reserve without deduction, until the Reserve stood at a much higher figure. The Secretary of State refused to accede to the request of the Government of India "in view of the pecuniary disadvantage of holding a part of the Gold Standard Reserve in gold" and he accepted the responsibility for realizing gold securities instead of gold when occasions arose.

The Secretary of State further informed the Government that he would shortly revive the arrangements which were in force in 1905, 1906 and 1907 for the purchase of gold in transit to England as the stock of gold exceeded £5,000,000. In those years gold destined for India was bought in transit by the Secretary of State from the Exchange Banks, and diverted to England by Council Drafts which carried special rates thus to attract gold.

Main departures from the recommendations of the Committee summarised :—

1. The idea of a gold Mint for India was dropped in 1902.

2. The coinage was resumed in 1899 and 1900 to meet the needs of the public.

3. Sovereigns were issued in 1900, but could not circulate owing to famine conditions and the Government admitted defeat very soon.

4. The Gold Standard Reserve was formed in 1900, but profits on coinage of the preceding year were temporarily unavailable.

5. In 1907 £1 million of gold out of the profits on coinage was diverted for railway capital expenditure to which later on half the profits were to be diverted.

6 A portion of the Reserve since 1900 began to be invested in short-term gold securities and gold was located in London and not in India

7 Reverse Councils were sold on London in 1907-08

8 "But when, in 1909, the Government of India reported that sovereigns were in demand and at a premium, the refusal of the Secretary of State to permit a substantial holding of gold in India, in order to make a gold currency possible, marked a deliberate departure from the Government's policy as laid down in 1899

In taking these steps the Government diverted in a subconscious and tentative measure in the direction of the Gold Exchange Standard The offer of the Secretary of State in 1904 to sell Council Bills indefinitely and the sale of Reverse Councils in 1907-1908 enabled the Government to come nearer the Lindsay Plan and to move away from the path laid down by the Fowler Committee, namely, the ultimate adoption of the gold standard

Mechanism of the Gold Exchange Standard

The Gold Exchange Standard which remained in operation from 1898 99 to 1915-16 has been summarised by Mr. Keynes as below —

"(1) The rupee is unlimited legal tender and, so far as the law provides, inconvertible

(2) The sovereign is unlimited legal tender at £1 to 15 rupees and is convertible at this rate, so long as the Notification issued in 1893 is not withdrawn, *i e*, the Government can be required to give 15 rupees in exchange for £1

(3) As a matter of administrative practice, the Government are, as a rule, willing to give sovereigns for rupees at this rate but the practice is sometimes suspended and large quantities of gold cannot always be obtained in India by tendering rupees

(4) As a matter of administrative practice, the Government will sell in Calcutta, in return for rupees tendered there, bills payable in London at a rate not more unfavourable than 1*s* 29/32*d* per rupee

The fourth of these provisions is the vital one for supporting the sterling value of the rupee and although the Government have given no binding undertaking to maintain it, a failure to do so might fairly be held to involve an utter breakdown of their system

Thus the second provision prevents the sterling value of the rupee from rising above 1*s* 4*d* by more than the cost of remitting sovereigns to India, and the fourth provision prevents

it from falling below 1s 3 29/32d This means in practice that the extreme limits of variation of the sterling value of the rupee are 1s $4\frac{1}{8}d$ and 1s 3 29/32d "[9]

THE CHAMBERLAIN COMMISSION

In view of the criticism of the currency and exchange policy of the Government, a Commission was appointed in April 1913 with Sir Austin Chamberlain as its Chairman and it issued its report in February 1914 The terms of reference of the Commission included "the measures taken by the Indian Government and the Secretary of State for India in Council to maintain the exchange value of the rupee in pursuance of or supplementary to the recommendations of the Indian Currency Committee of 1898"

ITS MAIN RECOMMENDATIONS

The Commission laid down that "The time has now arrived for a reconsideration of the ultimate goal of the Indian currency system The belief of the Committee of 1898 was that a gold currency in active circulation is an essential condition of the maintenance of the gold standard in India, but the history of the last 15 years shows that the gold standard has been firmly secured without this condition

"It would not be to India's advantage to encourage an increased use of gold in the internal circulation

"The people of India neither desire nor need any considerable amount of gold for circulation as currency and the currency most generally suitable for the internal needs of India consists of rupees and notes

"A mint for the coinage of gold is not needed for purposes of currency or exchange, but if Indian sentiment genuinely demands it, and the Government of India are prepared to incur the expense, there is no objection in principle to its establishment either from the Indian or from the Imperial standpoint: provided that the coin minted is the sovereign (or the half-sovereign), and it is pre-eminently a question in which Indian sentiment should prevail

"If a mint for the coinage of gold is not established, refined gold should be received at the Bombay Mint in exchange for currency

"The Government should continue to aim at giving the people the form of currency which they demand, whether rupees, notes, or gold, but the use of notes should be encouraged

"The essential point is that this internal currency should be supported for exchange purposes by a thoroughly adequate reserve of gold and sterling"

---

[9] Keynes, *Indian Currency and Finance*, pp 6 and 7

It will be seen that the Chamberlain Commission gave up the ideal of a gold standard based on a gold currency "and accepted in its place an exchange standard with an excrescent currency of sovereigns not essential to the working of the system" No action was taken on its recommendations owing to the outbreak of the War

Effects of the War on Indian Currency

The effects of the War may be considered under two periods In the first period from August 1914 to the Autumn of 1915, exchange became very weak, savings banks deposits were withdrawn to a great extent, a demand for the encashment of currency notes ensued and there was a great run on the Indian gold stocks These demands of the public were freely met and the embarrassing situation disappeared at the end of the period and on the whole it may be said that the Government met the situation boldly and successfully Currency notes were readily encashed as they were presented and adequate facilities for remittance abroad were provided to the public Confidence was thus restored

In the second period from 1915 to the end of 1919, there was a rapid rise in the price of silver and it was difficult to obtain it for coinage There was a large excess of exports over imports Indian exports were required by the Allies for the prosecution of the War and imports declined, firstly, because labour and capital were diverted for the production of war materials in foreign countries and, secondly, because insurance premia rose very high The exchange thus became embarrassingly favourable to India

The Government of India had to incur a huge expenditure on behalf of His Majesty's Government and between 1914 and 1919 £240 million had been spent on military equipment in the eastern theatres of the War and on civil expenditure in the occupied territory The financing of purchases in India on behalf of the Dominions and the Colonies had also to be done Thus a very heavy demand for Indian currency was created Council Bills on a very extensive scale had to be sold in London to pay for Indian exports and the coinage of rupees became necessary which sent up the price of silver The rise in the price of silver was due to the shortage in the supply of the metal, internal disturbances in Mexico, unusually keen demand for it on account of the shortage of gold and also because there was a universal desire to conserve the supplies of the metal When the price of silver rose very much, rupees began to be melted by people notwithstanding its prohibition by law as the intrinsic value of the coin exceeded its bullion value The cross rate moved against England and was pegged or fixed at \$4 76 £1 by the American and the British Governments When in

March 1919 the dollar-sterling exchange was decontrolled, it went further against England and touched $3 40 to the £ Silver was purchased in America and as the dollar-sterling cross rate moved against England, the price of silver rose From 27 pence per ounce in 1915 the price of silver rose to 89 pence per ounce in December 1920

Measures taken by the Government

(*a*) The Government controlled the exchange and fixed it at 1*s* $4\frac{1}{4}d$ in January 1917 Council Bills were sold only to the selected banks and firms and these were required to do business with third parties at the prescribed rates applying their resources mainly to selected articles of export which were of importance to the Allies

(*b*) The Government could not go on selling rupees to the public at 16*d* when the cost of manufacturing a rupee became much higher than 16*d* as silver rose in price In August 1917 exchange was raised to 1*s* 5*d* and the Secretary of State announced that he would base the rates of exchange on the sterling price of silver The result was a rise in the rate of exchange continuously with a rise in the price of silver, the highest point being 2*s* 11*d* in the early months of 1920

(*c*) *Purchase of silver* The Government had to take special measures to increase the supply of currency and silver was purchased from February 1916, and from September 1917 the import of silver on private account was completely prohibited to remove competition In 1918 the passing of the Pittman Act in America enabled the Government of India to purchase about 200 million ounces of silver at $101\frac{1}{2}$ cents per fine ounce

(*d*) Economy in the use of silver was exercised Notes, gold coins and nickel coins of the denomination of 2 annas, 4 annas and 8 annas were issued

(*e*) Currency was inflated Notes were issued without the usual metallic backing and there was a limitation on the daily issue of rupees to single tenderers of notes

(*f*) Certain financial measures as increased taxation, the lessening of capital and ordinary expenditure and the issuing of short term treasury bills were undertaken In these various ways heavy demands for currency in India were met

The Babington-Smith Committee

The Secretary of State on May 30, 1919, appointed a Committee presided over by Sir Henry Babington-Smith whose terms of reference were to make recommendations "ensuring a stable gold exchange standard" The Committee were thus precluded from considering any alternative standard and "this change from a gold standard to a gold exchange standard was

in absolute contravention of the currency policy officially adopted in 1899, binding on the Government and the country, and still existing as the recognized monetary system of India '[10]

MAIN RECOMMENDATIONS OF THE COMMITTEE

(1) The rupee without any change in weight and fineness was to remain full legal tender

(2) It should have a fixed exchange value expressed in terms of gold at the rate of one rupee for 11 30016 grains of fine gold, i e one tenth of the gold content of the sovereign

(3) The sovereign should be made legal tender in India at Rs 10

(4) A gold mint at Bombay should be opened for the coinage into sovereigns of gold tendered by the public and the import and export of gold was to be freed from Government control as soon as the change in the statutory rate to Rs 10 per sovereign had been effected

(5) The Government Notification to give rupees for sovereigns should be withdrawn

(6) The prohibition of private import and export of silver was to be removed

(7) The Gold Standard Reserve should contain a considerable proportion of gold and the aim should be to hold the remainder of the reserve in securities issued by Governments within the British Empire, other than the Government of India, maturing within 12 months Fifty per cent of the Gold Reserve was to be held in India

WHY THE COMMITTEE RECOMMENDED 2s RATE?

The Committee wanted to maintain the token character of the rupee and they thought that at 2s rate the rupee would be once more established as a token coin

A low rate would mean high prices which would have been disadvantageous to the poorer classes and to those having fixed incomes and, therefore, a high rate was recommended It was regarded as advantageous to Indian producers as it would keep down the cost of imported materials and machinery in rupees and would keep wages low The fear that exports would be discouraged was not regarded valid by the Committee because owing to the world shortage of raw materials and foodstuffs, the demand for Indian products abroad was very great

Finally, Government finances would improve a good deal and savings in sterling obligations would amount to 12½ crores

[10] *Minute of Dissent* of Sir Purushottamdas Thakurdas to the *Report of the Hilton-Young Commission*, page 114, para 44

of rupees if the old ratio were replaced by the new ratio of 2s. gold Of course there would be a loss in the revaluation of the sterling investments and of gold in London in terms of rupees, but it would be wiped out by savings in Home Charges over a number of years Taxation after some time would be reduced owing to a surplus of revenue caused by the high ratio It should be remembered that the rupee was to be fixed in relation to gold and not sterling

MINUTE OF DISSENT BY MR DALAL

Mr D M Dalal differed from the Committee in nearly all their recommendations and more especially in connection with the Committee's findings for a high rate In his opinion the rise in the price of silver could be prevented by releasing the embargo on its export and it was after the War that the greater part of rise in exchange was brought about A high ratio was opposed by him because it would disturb the relations between creditors and debtors, cause dislocation and set-back to various Indian industries and inflict losses on India's exports and might also turn the balance of trade against India There would be a loss on the revaluation of sterling securities and of gold in terms of rupees and there would be a very heavy loss if the sovereigns held by the public were to be redeemed at the statutory rate of Rs 15

The Government accepted the recommendations of the Committee and gave effect to them The various War time restrictions except the export duty on silver were abolished The sovereign was made legal tender in India at Rs 10 by the Indian Coinage Amendment Act No XXXVI of 1920 and thus the legal tender character of the sovereign and half-sovereign which was suspended by Ordinance No III of June 21, 1920, was restored The Government sold Reverse Councils to a great extent and Indian exporters were anxious to discount their export bills as quickly as possible to save themselves from the expected rise in exchange Later on, however, re-action set in and the demand for sterling became very intense because of the decision of the Government about the high ratio The firms and individuals who ordinarily would have waited for months to make remittances to England hastened to do so to take advantage of the high ratio There was an era of company floatation and orders for foreign plant and machinery were placed on a large scale Their cost was remitted in advance to take advantage of the high rate of exchange, so long as it lasted There was a speculation in exchange, for it was easy to make profits by first converting rupees into sterling at the high rate and then turning sterling back into rupees when the exchange came down according to the expectations of speculators

There was an adverse balance of trade after January 1920 which brought down the exchange rate to lower levels Heavy demand for sterling from speculators brought a rise in its value and a fall in the value of the rupee and sometimes the divergence between the market and the official rate amounted to 3*d* or 4*d* which further stimulated the demand for sterling By the end of June 1920 the market rates had fallen below the parity of even 2*s* sterling The Government then tried to maintain the rate at 2*s* sterling in place of gold Reverse Councils were met by selling sterling securities and treasury bills belonging to the Paper Currency Reserve These securities had been bought at Rs 15 to the £, but sold at Rs 7 to Rs 10 to the £ and there was thus a loss of about Rs 35 crores measured by the difference between their buying prices which were higher and their selling prices

The fall of exchange was ruinous to businessmen also This implied considerable deflation as the total value of notes in circulation had been reduced from Rs 185 crores to Rs 158 crores between February 1, and September 16, 1920 This was responsible for a stringency of money and fall in prices which increased the difficulties of businessmen who had to sell off their stocks at very low prices

The commercial community had thought that the Government would maintain the high rate of exchange and under that expectation had ordered goods, but exchange fell heavily by the time they arrived Businessmen did not cover their losses against a fall in exchange and most of them were ruined

Hilton-Young Commission

In April 1925 the exchange had reached 1*s* 6*d* or was held there as some people would put it, since then In 1921 the exchange had touched 1*s* 3*d* sterling or 1*s* gold and the 2*s* ratio remained ineffective for purposes of tender of gold to the currency office By January 1923 the exchange came up to 1*s* 4*d* sterling and showed a tendency to rise In October 1924 it reached the level of 1*s* 6*d* sterling equal to about 1*s* 4*d* gold From that time till March 1926 it showed an upward tendency, " but it was prevented from rising above 1*s* 6*d* by free purchases of sterling on the part of Government " In the meantime sterling was restored to parity with gold and the rupee remained in the neighbourhood of 1*s* 6*d* gold later on

On August 25, 1925, a Royal Commission on Indian Currency and Finance with Lt -Commander Hilton-Young was appointed and its Report was published on August 4, 1926 Its recommendations fall under three heads (*a*) Choice of the Monetary Standard, (*b*) The ratio problem, and (*c*) the case for a Reserve Bank

Before considering and propounding their own scheme for a suitable monetary standard for India, the Commission pointed out the defects of the Gold Exchange Standard and after a due consideration of the alternative proposals recommended the establishment of a gold bullion standard for India.

The Commission summarised the defects of the Gold Exchange Standard as below —

"(1) The system is far from simple, and the basis of the stability of the rupee is not readily intelligible to the uninstructed public The currency consists of two tokens in circulation, with the unnecessary excrescence of a third full-value coin which does not circulate at all One form of token currency (into which there is an unlimited obligation to convert the other) is highly expensive, and is liable to vanish if the price of silver rises above a certain level

(2) There is a cumbrous duplication of reserves, with an antiquated, and dangerous, division of responsibility for the control of credit and currency policy

(3) The system does not secure the automatic expansion and contraction of currency Such movements are too wholly dependent on the will of the currency authority"[11]

---

[11] Writing about the lack of automatic expansion and contraction of Indian currency, the Commission observe as below in para 16 of their *Report* —

"The automatic working of the exchange standard is thus not adequately provided for in India, and never has been The fundamental basis of such a standard is provision for the expansion and contraction of the volume of currency As the reserve rises or falls with a favourable or an adverse balance of trade the currency must be automatically expanded or contracted, and the adjustment between internal and world prices maintained Under the Indian system contraction is not, and never has been, automatic On occasions the obligation to buy sterling exchange has been discharged by the Government without any corresponding expansion of domestic currency the purchases having in the first instance been made against Treasury balances and the currency expansion has been left to be effected subsequently at the discretion of the Government More serious has been the absence of contraction on occasions when the currency authority has had to sell sterling exchange The following table shows how far the sales of reverse bills in the past have been accompanied by contraction of currency —

Years	Amount of reverses sold £	Rupees received for reverses sold Rs Lakhs	Amount of contraction effected Rs Lakhs
1907-08 09	8,058,000	12 16	12,16
1909-10	150,000	24	*Nil*
1914-15	8,707,000	13,16	1,05
1915 16	4 893,000	7,38	31
1918 19	5,315 000	7,08	*Nil*
1919 20 21	55,532,000	47,14	34,68"

(4) The system is inelastic "The utility of the provision for elasticity made on the recommendation of the Babington-Smith Committee is affected by the methods of financing Indian trade" (Para 21 of the Report) The reference in the last point is to the provision of Rs 12 crores of loans which can be granted to the Imperial Bank under an Act of 1923 against genuine bills of exchange

OTHER DEFECTS

(5) It did not command the confidence of the public and a large measure of distrust was justified by the imperfections of the system

(6) The basis of the system was far from being simple, certain and stable and though a substantial measure of stability in the past was attained, it lacked certainty and simplicity without which there can be no confidence

The Commission considered the following alternative systems —

(a) STERLING EXCHANGE STANDARD

The Gold Reserve and the Paper Currency Reserve might be constituted as one single reserve under the control of one currency authority which might be required by law to sell rupees for sterling without limit at the upper gold point of a fixed parity and to sell sterling for rupees at the lower gold point of the same fixed parity Thus a perfect sterling exchange standard both automatic and elastic in its contraction and expansion and efficient to secure stability might be developed It would require the least possible metallic reserves and would be the most economical from the point of view of the Indian tax-payer It was rejected for the following reasons —

(1) The silver currency would still be subject to the threat implied in a rise in the price of silver and if sterling were to be divorced from gold, the rupee being linked to sterling, would suffer a similar divorce

(2) Indian prices would have to follow sterling prices to any heights to which the latter might go or India would have to absorb a portion of this rise by raising her exchange

---

This was due to fear that the monetary stringency which would have resulted from a full contraction would have dislocated business In 1920, there were revenue deficits and a large amount of maturing debt which made greater contraction difficult "However that may be, it is clear that on such occasions the exchange standard was not being applied, and possibly could not have been applied in a normal manner There was nothing in the Indian system to enforce such an application In 1920 the consequences were disastrous There must ever be danger of such disaster under a system which does not automatically enforce contraction of internal currency concurrently with the depletion of Reserves" (Para 17 of the *Report*)

(3) There was a disadvantage for India in dependence on the currency of a single country however stable and firmly linked to gold

(b) THE PERFECTION OF THE GOLD EXCHANGE STANDARD

The currency authority could undertake to buy and sell, at the upper and lower gold points respectively and to unlimited amounts, the currencies of any of the principal foreign countries on a gold standard In theory, the rupee would not be stabilized in relation to gold If the currencies of all such countries with which the rupee was to be related were to vary in relation to gold, the rupee would also similarly vary in relation to gold In practice the rupee would be stabilized in relation to gold because as the Commission thought it would be improbable that there should be variations between gold and the currencies of the gold standard countries The advantages claimed for the system were that the rupee would be stabilized as it would be convertible into international currency at the will of the holder, the reserves would be simplified, the parity with gold would be established by law and the system would be as automatic as the systems of the U S A and England

It was rejected on the following grounds —

(1) The silver rupee would vanish as soon as the rise in the price of silver exceeded the melting point of the coin Then it would be necessary to stop the coinage of the silver rupee of the present weight and fineness

(2) It would not have the simplicity which is essential to secure the confidence of public opinion under present conditions in India The mechanism of an exchange standard is refined and people see nothing tangible behind the token currency to assure its value

(3) There is a large body of public opinion in India that is suspicious of the mechanism of an exchange standard

(4) Without some backing more certain, simple and solid, confidence in the stability of the currency will grow more slowly than it should, if it grows at all, and progress in the habit of banking and investment will be delayed "In the present state of its development Indian public opinion will have confidence in one thing only as solid enough for a backing for its currency and that is gold It requires some link that is real, and not only real but conspicuously visible, between the currency of the country and gold" (Para 31 of the *Report*)

(c) GOLD STANDARD WITH A GOLD CURRENCY

The Finance Department of the Government of India prepared a scheme under which the silver rupee would cease

to be legal tender, except for small amounts, after a period during which it would have been convertible into gold currency. The objects thereof were firstly, to simplify the constitution of the reserves by eliminating silver from them and to eliminate the threat to the currency inherent in the possibility of a rise in the price of silver by dethroning the rupee from its position as a standard coin of unlimited legal tender and secondly, to promote banking and investment habit by assuring the people that they will get gold in exchange for notes

The reasons for rejecting the scheme are given below —

(i) The effects of India's additional demand for gold upon the future of the gold market would be very adverse as denoted by the evidence received by the Commission from eminent economists as Prof Gustav Cassel and Mr Joseph Kitchen A large extra demand from India for gold would cause increased competition for gold among the countries of the world and lead to a substantial fall in gold prices and a substantial curtailment of credit which would be unfavourable to India also It was also pointed out that a large quantity of fine gold was not available in America for Indian requirements

(ii) The Finance Department had estimated that the initial demand for gold in India would amount to Rs 50 crores and the total demand which would be spread over a period of ten years would amount to Rs 137 2 crores The Commission did not accept this estimate as absolutely reliable and pointed out that there could be no certainty that the demand would be spread over ten years' period

(iii) *Effects on the Silver Market* would be very adverse. The prices of silver would fall very much, firstly, because the European countries were meeting the demand for subsidiary coins by copper and nickel coins and secondly, India would be meeting her demand by melting rupees , but on the other hand, the supply of silver would not fall as silver is a " by-product of the yellow metal and rich mines would not curtail production while the poorer mines would continue to prolong production as much as possible ' Moreover, the increase in the demand for gold would further depress the gold price of silver

(iv) *The effect upon Silver Hoards in India* would be very adverse Those who had put their savings in silver, the poorer classes, would be deprived of a large portion of their savings by a fall in the price of the white metal and the Government would also lose heavily as its reserves would depreciate The import duty might give some protection against this depreciation but then the Government would be under a moral obligation to maintain the price of silver practically for all time , for at the completion of the plan they would have sold nearly

700 million ounces of silver to the people at a price that was possibly double the world price

(v) *The effect on China* would be that she might be inclined to adopt the gold standard as the Chinese "have for a long time been trying to find some means of substituting gold or some form of gold standard as the basis of their currency," because the bulk of her trade was carried on with countries on gold standard "The catastrophic fall in the price of silver in terms of gold which would take place on the bare announcement that surplus silver equal to the world production for three years was for sale, would undoubtedly tend greatly to accelerate the movement in China and might induce her immediately to set about securing the gold needed as a basis for instituting some form of gold exchange standard" That would depress the prices of silver still further as China would also sell silver

(vi) *Raising the required credits* would be very difficult The U S A would not be willing to grant the requisite gold as the country was much interested in the price of silver, being a great silver producing country Great Britain would not co-operate with India without the help of the U S A "Both authorities view the proposal with alarm on the grounds that it would retard the progress of monetary reconstruction in Europe, would upset world prices, and would be fundamentally harmful both to India and to the rest of the world In these circumstances it appears that insuperable difficulties would be encountered in obtaining the necessary credits" (Para 51 of the *Report*)

The Commission did not also accept that the scheme would attain the object of educating the Indian people in the habits of banking and investment more speedily than any other scheme would For all these reasons, the scheme was rejected

GOLD BULLION STANDARD

The Commission recommended a Gold Bullion Standard for India They arrived at the conclusion that in order to secure public confidence in India, the currency of the country must be linked with gold in a manner that was real and conspicuously visible, or, in other words, that it was necessary to establish a true gold standard They proposed that an obligation should be imposed by statute on the currency authority to buy and sell gold without limit at rates determined with a fixed gold parity of the rupee in quantities of not less than 400 fine ounces and there was to be no limitation with regard to the purpose for which gold was required This would secure the stability of the gold value of the rupee and exchange would be stable within the gold points

The fact that the demand for gold in India is not purely for monetary purposes was to be taken into view "It is essential, therefore, that the conditions which are to govern the sale of gold by the currency authority should be so framed as to free it in normal circumstances from the task of supplying gold for non-monetary purposes In order to achieve this object we propose to fix the selling prices of gold at rates which will enable the bank to replenish its stock of gold without loss by importation from London Thus when exchange is at the upper gold point the selling price for delivery at Bombay will be the par value, *i e*, Rs 21—3—10 per tola When exchange is below this point, the Bank will be required to sell gold for delivery in London or Bombay at the option of the purchaser at certain notified prices These prices will be determined by the cost at which gold could be respectively purchased in London or laid down in Bombay from London when exchange is at the lower gold point The option to the purchaser on the other hand to buy gold for delivery in London at the prices determined leaves the margin between the upper and lower gold points of the exchange as narrow as it could be, having regard to the cost of moving gold to and from its most convenient gold centre" (Para 65 of the *Report*)

The legal tender quality of the sovereign was recommended to be removed The obligation was to sell gold bars and, therefore, no gold coin was recommended to remain in circulation

Gold saving certificates payable in gold were to be introduced because the obligation to buy and sell gold bars in quantities of not less than 400 ounces would have only an indirect effect upon the people in establishing confidence in the currency as bankers and bullion brokers only would make direct use of the provision To bring home to the masses the fact that gold would be the standard of value savings certificates were to be issued, redeemable in three or five years in legal tender money or gold at the option of the holder They were to be issued in denominations of one tola and integral number of tolas, and sold for legal tender money, rupees and notes, at a price which would give the holder an attractive yield in interest The holder was to be given facilities to get them encashed at any time during their currency at certain rates of discount, but until the date of maturity they would be paid in legal tender money and not in gold

These certificates were to demonstrate to the holders the advantages of and provide an incentive to investment and they were to be a powerful antidote to hoarding They were expected to solve the problem of India's hoards

This scheme was to have the same advantages as could flow from a gold currency It would provide stability to the currency system as people would have confidence that the basis of currency was gold It would be simple and certain and would provide elasticity to the currency system When gold bars were given by the currency authority for notes or rupees, the currency would be expanded It would leave the door open for the introduction of a gold currency if in future it was thought proper and practicable to introduce it The experience of Europe and the U S A proved that a gold currency was not necessary for a gold standard

Convertibility of Notes into Silver Rupees

There was to be no obligation to convert the new notes into silver rupees, but this obligation was to continue with regard to the notes of the Government of India so long as these notes were to remain in circulation In practice, however, rupees were to be made freely available to people in order to secure the latter's confidence One rupee notes were to be introduced and notes of higher denomination were to be converted into notes of smaller denomination or silver rupees at the option of the currency authority "This statutory provision would in form leave it optional with the currency authority to determine the form of legal tender money to be supplied but we propose to ensure that all reasonable demands of the public for metallic currency shall be met in practice" The Paper Currency Reserve and the Gold Standard Reserve were recommended to be unified to secure simplicity

Composition of the Combined Reserve

The Committee proposed that in the first place the composition of the combined reserve should be fixed by statute This would secure the automatic expansion and contraction of the currency Secondly, it should be laid down that gold and gold securities should not be less than 40 per cent of the Reserve, though the currency authority should keep a reserve ratio of 50 to 60 per cent in view of the obligations imposed upon it If the proposed Gold Savings Certificates proved popular the Government would require more gold to encash them on maturity, but the extent to which more gold would be required would depend upon experience

The holding of gold was recommended to be raised to 20 per cent as soon as possible from about 12 8 per cent at which it stood at the time the Commission made its recommendations It was to be raised to this percentage in five years and to 25 per cent in ten years' time "During this period no favourable opportunity of fortifying the gold holding in the Reserve should be allowed to escape" (Para 78 of the *Report*)

The Commission recommended that though silver reserves were out of place in a gold standard system, yet to meet genuine demands for purposes of circulation, it was necessary to hold a considerable quantity of rupees This demand was expected to be reduced with the growing popularity of the notes The silver holding in the reserve was to be reduced from Rs 85 crores to Rs 25 crores gradually within a period of ten years The balance was to be held in the Government of India rupee securities and self-liquidating trade bills The holdings of the Government of India rupee securities were to be limited to 25 per cent of the Reserve or Rs 50 crores whichever was less

It was further recommended that "the new Reserve will have to maintain the external convertibility of a circulation which includes both paper and silver tokens As regards the former, the liability will, of course, be equal to the total outstanding note circulation But in the case of the silver rupee such a cent per cent backing is neither possible nor desirable There is obviously an irreducible minimum below which the rupee circulation cannot fall, if the business of the country is to be carried on Moreover, even of that portion of the silver circulation which is potentially contractible only the difference between the face value and the realizable bullion value need be covered Any estimate on such a subject must be largely conjectural and subject to variations in the price and marketability of silver We have fixed a more or less arbitrary figure of Rs 50 crores as the assumed liability of the Reserve in respect of the contractibility of the rupee circulation" (Para 82 of the *Report*)

Stabilization of the Rupee

The Commission argued that the time was fully ripe for stabilizing the rupee in view of the fact that the United Kingdom, the Dominions and other countries were returning to the gold standard and gold prices were more or less stabilized So long as there was no such stability, there would be lack of confidence, commercial initiative would be discouraged and the machinery of commerce would be clogged and hampered The Commission, therefore, concluded that it was safer to stabilize the rupee than to wait "A stable exchange is an inestimable boon," and, therefore, the Commission did not think it desirable to postpone it for the sake of absolute security which was unobtainable in the practical world

They recommended 1*s* 6*d* gold as it had been the prevailing rate since June 1925 At this rate the prices in India had attained a substantial measure of adjustment with those in the world at large and any change in the rate would mean a difficult period of readjustment involving widespread economic disturbance Their arguments were as below —

(i) From December 1922 to June 1924 the rupee remained fairly stable round 1*s* 3*d* gold, but the rupee price level ranged round a mean of about 176

(ii) In the following year, the rupee price level fell below 160 while the rupee was rising to 1*s* 6*d* gold The rupee had risen to about 1*s* 6*d* gold by January and was held within 1*s* 6*d* gold points since June 1925 From July 1924 to June 1925 the rupee price level fell from 179 to 157 and varied within the limits of 163 and 153 since then (Para 182 of the *Report*)

(iii) Since then the rupee had been about 1*s* 6*d* gold and the rupee price level ranged round a mean of about 158 with a tendency to fall in sympathy with world prices

The level of world gold prices was approximately the same at the beginning of period (i) and at the end of period (iii), showing thereby that a substantial equilibrium was attained about the middle of 1925 and was since maintained

The main argument of those who doubted the adjustment of world prices to 1*s* 6*d* was that it was not till June 1925 that the rupee had attained 1*s* 6*d* gold Since then the rupee prices had been practically stable in relation to world prices and hence the adjustment had yet to take place The Commission argued that though the rupee did not definitely reach 18*d* gold till June 1925, it had already traversed more than 80 per cent of its upward journey from 15*d* to 18*d* gold between July 1924 and January 1925 and before June 1925 there had already taken place a heavy fall in rupee prices in relation to world prices

The fact that exchange had remained steady during the preceding 12 months was another indication of equilibrium between external and internal prices It was urged against this view that exchange had been kept at 1*s* 6*d* by Government manipulation, but the Commission argued that the so-called manipulation was confined to an addition of nine crores to the note circulation during the busy season and a withdrawal of 8 crores at the end of it

The fact that there was no adverse effect upon exports and imports was another indication of adjustment between external and internal prices "All the above considerations point to the same conclusion, *viz*, that after twelve months of the 1*s* 6*d* rate of exchange, substantial adjustment of prices has been attained, and this conclusion is borne out by the experience of other countries which have recently stabilized their exchanges"

Wages were also in adjustment with the prevailing level of prices and exchange Prices react on wages sooner or later

all over the world and it may take a longer time in India for this adjustment to take place than in Western countries having organized industries, still the economic tendency exerts its influence in the same direction. In India a much larger sum is spent on foodstuffs than in Western countries, "and therefore there is a very necessary ultimate adjustment of wages to the price of food grains." Where exchange and prices were steady for a considerable period it might be assumed that wages were in adjustment unless there were any indications to the contrary. The Commission argued that the statistics of foreign trade strengthened this assumption. In agriculture, the premier industry of India wages were rising, a tendency that might be expected to facilitate adjustment to falling prices which operate as a check to the rise in wages. In the case of Government services also the Government had refused increases in pay because of falling prices. On the whole, the Commission saw no reason to believe that there was any general maladjustment in agricultural wages or in wages in manufacturing industries. The latter industries were suffering from foreign competition and not from high wages. To inflate currency to the extent of 12½ per cent would produce a concealed reduction in wages of an equivalent percentage. Even if it would secure the desired equilibrium the Commission did not regard it as a sound policy to use the currency as a lever to reduce real wages. Any adjustment of wages thus brought about would be arbitrary and temporary.

The effect on outstanding contracts was also considered by the Commission. *1s 6d* was not regarded as a hardship in the case of land revenue because prices had risen to a great extent since 1914 or since the time that such contracts were entered into. With regard to other long-term contracts the Commission pointed out that the ratio had been in an unstable condition for about a decade. It broke away from *1s 4d* gold in 1917 taking an upward direction and continued rising till it touched *2s* gold in February 1920. Then it fell rapidly to 11½*d* gold in 1921 and rose since then till in June 1925 it reached *1s 6d* gold and there it remained since then. A larger number of contracts must have been entered into at the fluctuating rate in the past nine years than at the old rate. Therefore, it was impossible to do absolute justice and in modern times long-term debts form only a small part of the total contracts outstanding the great bulk of them being short-term contracts which must have been entered into at the fluctuating rate.

"We conclude, therefore, that from the point of view of contracts as well as from that of prices and wages, the least disturbance will be caused, and the least injury will be done to all the interests concerned, by adhering to the *de facto* rate." (Para 196 of the *Report*.)

The Commission Answer the Arguments for 1s 4d

The advocates of 1s *4d* pointed out that this rate was a "natural" rate, but the Commission did not accept this contention They argued that "fluctuations in exchange are produced by the mutual interaction of internal and external prices, and as the level of internal prices is determined mainly by the volume of internal currency the only rate which can properly be regarded as natural is the figure at which these prices are in adjustment with the existing volume of currency and are also in equilibrium with external prices From this point of view 1*s* 6*d* appears to be clearly the "natural" rate under present conditions The term, however, appears to be loosely used to denote the rate which would result if no attempt were made either by statutory enactment or executive action to anchor the rupee at a particular point If such a policy were adopted there can be no doubt that in a country like India where there are wide seasonal fluctuations of trade, there would be similarly extensive fluctuations in the rate of exchange amidst which it would be impossible to distinguish any particular rate as natural"

Another argument of the advocates of the lower ratio was that as it was secured through Government manipulation, disturbances in it would be less harmful than disturbances in the other rate The Commission replied that when prices and other conditions were in adjustment with those in the world at large on the basis of an existent exchange rate, the question of the means by which that rate came into existence had no bearing on the extent or violence of the economic disturbances which would be caused by changing the rate

It was also pointed out that the lower rate would reduce the total demand for gold in connection with the introduction of a gold standard and further that in case of the failure of the monsoon, it would be easier to maintain the lower rate than to maintain the higher rate as the latter one would require more gold and sterling reserves The Commission argued that the lower rate would require an increase in circulation of the monetary unit by an equal percentage and, therefore, the same reserve of gold would be necessary as at the higher rate As regards the second suggestion it was pointed out that if gold and gold securities reserves were sufficient for effecting the necessary contraction of the rupee circulation, there was no ground for thinking that it would be more difficult for the central currency and banking authority, with full power to make its credit policy effective, to maintain 1s 6*d* exchange than to maintain 1s 4*d* rate

The testing time would come in case of successive bad monsoons, but the Commission suggested that it would come

equally at the 1*s* 6*d*, 1*s* 4*d* or any other rate and that the ability to maintain the rate would depend not upon the rate itself but upon a proper utilization and maintenance of adequate gold reserves

Another argument for 1*s* 4*d* was that at that rate it would be easier to meet foreign competition than at the higher rate The Commission argued that when foreign currencies were stabilized 1*s* 4*d* ratio would not leave India in a better position and during the period of instability of foreign currencies it was desirable to apply other remedies than to manipulate the currency If other countries depreciated their currencies, that was no reason why India should do so

The case for the low rate was supported on the ground that India absorbed abnormal quantities of gold because the metal was cheaper at the higher rate than at the lower rate and to put a check to this increasing absorption, the rupee price of gold should be raised by lowering the gold value of the monetary unit The Commission argued that a change in the gold value of the rupee would involve a corresponding change in the rupee prices of commodities and that the mere lowering of the ratio could not result in more than a temporary alteration in the relative cheapness of gold and general commodities It was not possible to cure India's appetite for gold by lowering the exchange The only safe method to eradicate this wasteful habit was to stabilize the currency, establish confidence in its stability, educate people in the habit of investment and extend banking facilities

Another argument for the lower ratio was that in case world prices fell in future, 1*s* 6*d* ratio would accentuate the fall in India and make it specially embarrassing to maintain the ratio The Commission argued that the fall in prices in 1920 was abnormal and was an aftermath of a world-wide upheaval, a reaction from the enormous expansion of credit that took place during the War and that it would be imprudent to base the currency on the supposition that such conditions were likely to recur If stability was aimed, it must be assumed that the period of catastrophic disturbances was over and that prices in future would be normal [12] Further it was a risk in the opinion of the Commission to which India would be subjected at any ratio

ECONOMIC EFFECTS OF 1*s* 4*d* RATE

The Commission argued that the economic effects of 1*s* 4*d* ratio would be very bad The lower rate would

[12] In this case the advocates of 1*s* 4*d* ratio proved to be right The fall in prices since 1920 has been much more severe than the one in 1920 and at 1*s* 4*d* conditions would have been better because the higher ratio accentuated the fall in prices in India

raise prices by 12½ per cent which would be severely felt by consumers in general, and by those with low fixed incomes, i e, by the poorly paid members of the literate class It would also mean an arbitrary reduction in the real wages of labour

The adoption of the lower rate would induce the remitters of money to England to make an endeavour to obtain the best price for rupees which they could get until the rate announced were reached The tide would then turn the other way and there would be a very large demand for rupees at the new rate which would be met by an offer to buy exchange without limit at the gold import point thereby making additions to currency It would lead to violent fluctuations before exchange settled down at the new lower rate "Whether such fluctuations took place or not, the sudden fall in exchange might easily create a boom which would be followed later by a slump"

Effect on Public Finances

The Commission did not regard the effect on public finances as decisive, but they could not ignore the fact that a reversion to 1*s* 4*d* would lead to increased taxation and would give a set-back to the nation-building departments The net sterling expenditure of the Government would be increased by about three crores per annum and the railway expenditure also would increase It would either imply an increase in railway rates and fares or a revision of the terms of the Railway contribution There would be some extra expenditure on stores purchased in India and adjustment would be necessary in the salaries of Government servants Of course, there would be an increase in customs revenue "What is clear is that the immediate loss from the standpoint of public finance would be considerable and would require to be made up by increases in taxation, if the budget were to be balanced, and by still further increases, if further reductions in the provincial contributions or in existing forms of taxation were to be made"

A reversion to the lower rate would lower the credit of India in foreign markets, because the financial credit of the Government depended upon the balancing of the budget The reversion to the lower rate would disturb the budgetary equilibrium and would necessarily impair India's credit with regard to borrowing

The melting point of the rupee would be reached earlier at 1*s* 4*d* than at 1*s* 6*d* and the rise in the price of silver would present the difficulties of preventing the melting of rupees to a greater extent at the lower rate than at the higher rate At 1*s* 4*d* the sovereign is equal to Rs 15 whereas at 1*s* 6*d* it is equal to Rs 13—5—4, a sum which would be inconvenient

if the sovereign were to circulate as money Even this objection according to the Commission was not as strong as it appeared at first sight because a crore of rupees would be exactly three-quarters of a million pounds But when the legal tender character of the sovereign was removed, the objection lost much of its force

Sir Purushottamdas Thakurdas made out a very strong case for the lower ratio and some of the arguments advanced by him have already been considered He pointed out the evil effects of the high ratio on producers and manufacturers in India for it would retard the industrial development of the country by enabling foreign goods to come cheaply into India and it would neutralize protection to the extent of 12½ per cent He did not accept the contention of the majority that adjustment of prices had taken place at 1*s* 6*d* rate He pointed out the vital importance of the ratio in the following words[13] —

"I look upon the question of the ratio in this *Report* as being no less important than the question of the standard to be adopted for the Indian Currency System I am convinced that if the absolute necessity of the free flow of gold, which I have emphasized, is recognized, and steps taken to ensure it, the gold bullion standard proposed will be the correct one, and the likelihood of its breaking down under the strain of any convulsions in the future will be as remote as it can reasonably be But I have very grave apprehensions that if the recommendation of my colleagues to stabilize the rupee at 1*s* 6*d* is accepted and acted upon, India will be faced during the next few years with a disturbance in her economic organization, the magnitude of which is difficult to estimate, but the consequences of which may not only hamper her economic development, but may even prove disastrous Such a disturbance and its consequences my colleagues do not foresee to-day But the possibility of their occurring cannot be ignored Until adjustment is complete, agriculture threatens to become unattractive and less remunerative than it is to-day, and industries will have to undergo a painful process of adjustment, unnatural, unwarranted and avoidable—an adjustment which will be much to their cost, and affect not only their stability and their progress, but in certain cases, their very existence And should Nature have in store for India a couple of lean years after the four good harvests that we have had, during the period of forced adjustment to a rate of 1*s* 6*d*, the steps that the Currency Authority will have to take to maintain exchange at this rate may deplete the gold resources of the country to an extent that may seriously shake the confidence of her people in the currency system recommended"

[13] *Minute of Dissent* by Sir Purushottamdas Thakurdas to the *Report of the Hilton-Young Commission*, para 151

Referring to the effects of the higher rate on the debtor class, he pointed out that "A change to 1*s* 6*d* hits the large bulk of the debtor class, to the benefit of the creditor class I cannot conceive of any valid or moral reasons for a step calculated to give the latter an unearned increment at the expense of the former In India, perhaps more than anywhere else, the debtor class is the largest and the neediest, for whom the Government has always evinced concern and solicitude What unavoidable reason, then, is there to hit this class? Throughout the course of our enquiries I have not heard of a single argument, which I can reasonably accept as sound, even pointing to the inevitability, to say nothing of the justifiability, of imposing an additional burden on a class already over-burdened

Government's Action on the Report

Three Bills were published on September 16, 1927, embodying the recommendations of the Commission (i) a Bill to establish a gold standard currency for British India and to constitute a Reserve Bank, (ii) a Bill to amend the Imperial Bank Act of 1920, and (iii) a Bill to amend the Coinage Act of 1906 and the Paper Currency Act of 1923 and to lay upon the Government certain obligations for the purchase of gold and the sale of gold exchange The third Bill became law and came into force from April 1, 1927

It established the ratio of 1*s* 6*d* by enacting that Government would purchase gold at the price of Rs 21—3—10 per tola of fine gold in the form of bars containing not less than 40 tolas, and would sell gold, or at the option of the Government, sterling, for immediate delivery in London at the same price after allowing for the cost of transport from Bombay to London A rate of 1*s* 5 29/32*d* was notified as the Government's selling rate for sterling to meet these obligations Conditions attaching to the acceptance of gold at the Bombay Mint were also published The rupee-sterling exchange did not reach the upper gold point in 1927-28 and, therefore, no gold was tendered at the Mint In the busy season of 1928-29, conditions in the money market were such as to lead to the offer of gold in the form of sovereigns in exchange for currency

Sovereigns and half-sovereigns ceased to be legal tender in India by the same Act An obligation was imposed upon the Government to receive these coins at all currency offices and treasuries at their bullion value at Rs 21—3—10 per tola of fine gold, *i e*, Rs 13—3—10 per sovereign In 1927-28 the Government received sovereigns to the value of Rs 5,034

INDIAN CURRENCY HISTORY AFTER SEPTEMBER 1931

On September 21 1931, England went off the gold standard and suspended gold payments On the same date an Ordinance was issued by the Government of India according to which it suspended the appropriate section of the Currency Act of 1927 and withdrew the statutory obligation of the Government to sell sterling or gold against rupees The rupee was thus divorced from sterling because according to the Ordinance the Government was neither bound to sell sterling nor gold against rupees tendered in India Formerly the rupee was linked to gold through sterling and sterling was equivalent to gold Indian opinion welcomed the provisions of Ordinance VI of 1931 because the rupee would then find its own level and their expectations of a fall in the ratio might be realized It also implied that the ruinous exchange policy followed by the Government since 1927 had been given up

The Secretary of State made a different announcement in the Federal Structure Sub-Committee of the Second Round Table Conference and linked the rupee to the sterling When this announcement was received in India, the position was that the Finance Member had taken action which meant one thing and the Secretary of State had made a statement which meant quite another thing Under such circumstances the banks would have to conduct their business in a state of uncertainty when there was a conflict of views and policies The Government therefore, declared the three succeeding days as holidays under the Negotiable Instruments Act

Finally, Ordinance VII was promulgated on Friday, the 25th September with the following provisions —

(1) The rupee was linked to the sterling at 1*s* 6*d*, *i e*, the Government undertook the obligation to sell sterling at 1*s* 6*d*

(2) The sales of sterling were to be limited to requirements for genuine trade purposes for fulfilment of obligations incurred prior to September 21, 1931, and for reasonable domestic purposes

(3) The sales were to be through the Imperial Bank only at its branches at Bombay and Calcutta to certain recognized banks

This action of the Secretary of State was very much resented in India as the Assembly which was in session at that time was not taken into confidence by the Government A resolution was moved in the Assembly by Mr (now Sir) Shanmukham Chetty[14] who pointed out that the step was taken in the

[14] See the relevant issue of the *Indian Finance* for September 1931 in which the speech of Mr Chetty in connection with the measure was published *in extenso*

interests of England and the intention was to introduce imperial preference through back door The talk of stability was dispensed with as being useless because there was a "phantom stability" and real insolvency "The rupee is to follow the fate of the sterling depreciating as the latter depreciates"

Another disadvantage of the policy was that it would deplete the gold resources and since September 1931 up to August 1933 £ 120 million worth of gold was exported The course of action taken by the Government was against the definite recommendations of the Hilton-Young Commission

The main argument from the side of the Government was that it would involve a saving of about five crores of rupees to which Mr Chetty retorted, "Then again as for the budgetary position you may save five crores in your deficit through this policy, but this five crores is not to fall from the heaven You will get it by bleeding the agriculturist to the extent of 20 crores"

The Finance Member contended that India's external obligations being largely in sterling, if the rupee was not linked to it there would be almost insuperable difficulties of raising money in London or abroad to meet the normal sterling obligations amounting to 32 million pounds, but that fortunately they had the support of His Majesty's Government In this connection, the oppositionists pointed out that India could get credit in London even otherwise as England had been able to get in Paris and New York

Recent Controversy about Ratio

India has been feeling the bad effects of the slump in trade like other countries The Government had to take certain measures to maintain the 1s 6*d* ratio Firstly, the device of currency contraction was adopted, the net amount of which in 1929-30 was 1 080 lakhs of rupees It was effected largely by the transfer of sterling securities in the Paper Currency Reserve to the Secretary of State for his sterling expenditure against cancellation of currency in India and also the cancellation of rupee securities in the Paper Currency Reserve and the sale of silver in the reserve Secondly, treasury bills were issued to exchange banks and other purchasers to control credit to keep the exchange firm The Bank Rate of the Imperial Bank was raised to 6 per cent in October 1924 and to 7 per cent later on This was an abnormal step as the cash balance of the Bank was then very large, being in the neighbourhood of Rs 30 crores and when call money was available in Calcutta and Bombay at about 2 per cent

Mr G D Birla in a letter to *Manchester Guardian* on 29th September, 1931, described the currency policy of the Indian

Government as being responsible for many of the economic ills of India.[15] The disadvantages mentioned therein are as below —

(1) The fall in the prices of articles which India exports has been much more serious than that in the prices of articles which she imports—in natural consequence of an appreciated ratio The fall in the prices of imported articles between September 1929 and December 1930 was 16 per cent whereas that in those of exportable commodities was 36 per cent "Warnings which were repeatedly given turned out to be true"

(2) The purchasing power of the agriculturists fell very much and imports became as unsaleable as exports

(3) Deficit budgets became the rule rather than the exception

(4) Gold resources were frittered away and debts continued to be piled up A new debt of about 252 crores "has been contracted during the last seven years, and the rate which has been paid for three months accommodation has been anything from 1 per cent to 2 per cent higher than the rate at which banks have been able to obtain deposits for a like period No wonder that at times when money has been available in other financial centres at 2 per cent or 1½ per cent the Bank rates in Calcutta and Bombay have been as high as 7 per cent. or even 8 per cent The net contraction of currency from April 1, 1926, to date has amounted to about 125 crores Trade has suffered and so has industry The Indian agriculturist finds himself at present unable to meet his liabilities He is not in a position to-day to pay either the Land Revenue or the interest on the money he has borrowed No doubt the world depression is partly to blame, but it is the appreciated rupee which has precipitated a crisis in his case" Sir Purushottamdas Thakurdas had predicted this when he wrote in his *Note of Dissent* to the *Report* of the Hilton-Young Commission as below —"If gold prices fall—and Indian prices must follow such a fall—India will be faced with a still higher fall—the double effect of the operation of the present rate of 1s 6*d* and also the world fall I cannot but contemplate such a prospect with very serious misgivings for it will hit the Indian producer to an extent beyond his capacity to bear In a word it will hit, and hit very hard four-fifths of the population of the country that exists on agriculture" (Para 98, page 130 of the *Report*)

---

[15] See Appendix A to the *Report of the Federation of Indian Chambers of Commerce and Industry* on the Second Round Table Conference

The total interest bearing obligations of the Government till March 1931 stood as below —

March 31, 1934	919 00 crores
March 31, 1927	1,006 19 crores
March 31, 1931	1,171 96 crores

Mr Birla further wrote in connection with the step taken in 1931 to link the rupee to the sterling as follows —"The effect of this policy may be disastrous in many ways For one thing, the rupee, even if depreciated to the extent of 50 per cent in terms of gold, must remain at 1*s* 6*d* in terms of sterling, even if sterling does not depreciate more than, say, 20 per cent It can so happen because the British Government has already taken steps to see that capital is not exported out of Great Britain, and it is impossible not to suspect that this move is designed to help the British investor to bring his money back from India at 1*s* 6*d* when suspending the exchange standard entirely would have depreciated the rupee, not only in terms of gold, though to a greater extent, but also in terms of sterling"

REPORT OF THE RESERVE BANK COMMITTEE

The Reserve Bank Committee in Paragraph 19 of their *Report* observe that in the present state of monetary disorganization throughout the world, it is not possible to incorporate in the Bill provisions which would be suitable when monetary systems have been generally stabilized In these circumstances the only sound course for India is to remain on the sterling standard The Committee do not express any opinion upon the merits or demerits of the present ratio, but point out that there will not be any change in the *de facto* situation by the mere coming into operation of the Reserve Bank Act

A considerable majority of the Indian delegates regarded a suitable exchange ratio as one of the essential factors for the successful working of the Reserve Bank They were of the view that the Government of India and the legislature should examine all relevant considerations to ensure minimum possible strain on the Indian currency system Sir Purushottamdas Thakurdas in a separate note has pressed for a change in the ratio when he writes, "My own view is that, in fulfilling some of the prerequisites of the inauguration of a Reserve Bank, a review of the ratio is absolutely necessary" (For further details see the Chapter on Reserve Bank)

Recommendations with regard to Reserves are contained in Paragraphs 21 to 26 of the *Report* The Rupee Redemption Fund is to be dispensed with At the outset a sum of not more than Rs 50 crores should be transferred to the Bank. Any surplus above this amount which would be removed

from the reserves should be held by the Government as bullion and not as coin If in any year the minimum holding of rupees by the Bank exceeds 50 crores or one-tenth of the whole reserve it can make over the surplus to the Government to the extent of Rupees five crores in any year and the Government will have to pay full value for this to the extent of 40 per cent in sterling or other external assets acceptable to the Bank if the Bank s external assets at this time did not exceed 50 per cent of its reserves The Reserves of the Bank are to have an ample margin over the statutory minimum and the initial portion of gold and sterling assets must not be less than one-half of the liabilities of the Issue Department

RUPEE SECURITIES

According to Clause 31 (3) of the Reserve Bank Bill of 1928 the amount held of the Government of India rupee securities was not to exceed at any time one-fourth of the total Reserve or Rs 50 crores whichever was less and the Committee have recommended that the provision should be further examined lest it should prove too restrictive to the open market operations of the Bank

Gold securities have been recommended to be replaced by sterling securities Gold coin or bullion and sterling securities are to be 40 per cent of the Reserve There is to be a minimum gold holding of Rs 35 crores Sir Purushottamdas Thakurdas wrote a *Minute of Dissent* because the Committee did not fix a minimum gold holding in relation to the note issue His view is that the whole of the present gold holding of Rs 44½ crores should be earmarked as the minimum gold reserve In case Rs 35 crores is accepted as the minimum, the percentage of gold to the note issue should not be less than 15 per cent and he prefers the first alternative i e , of preserving the present gold holding intact, because he writes that "I appreciate the difficulty of requiring the Reserve Bank to buy gold at a premium should the currency recovery of the world be slow and difficult" (For further details see the Chapter on Reserve Bank)

INDIAN PAPER CURRENCY

Before 1860 the three Presidency banks were allowed to issue notes payable to bearer on demand subject to certain regulations with regard to maximum issue and reserves In that year a scheme for Government paper currency was introduced and the right of note issue was taken away from the banks The Paper Currency Act of 1861 divided the country into seven circles of issue namely, Calcutta Cawnpore, Lahore, Madras Bombay, Karachi and Rangoon, and notes of the denomination of Rupees 5, 10, 50, 100, 500, 1 000 and 10,000 were issued They were to be issued without limit

in exchange for rupees or British gold sovereigns to the public and in exchange for gold bullion on the requisition of the Controller of Currency Within their respective circles of issue they were declared unlimited legal tender at the Government treasuries and in private transactions

A certain fixed amount of notes was backed up by the Government of India Rupee Securities as a guarantee for their convertibility Beyond this sum a reserve of bullion and coin was to be kept to the full value of the notes issued Though as a right, they could be encashed at the head office of the circle of issue only, notes of other circles were encashed at Government treasuries for *bona-fide* travellers and railway companies Government dues could be paid in the currency notes of any circle

In 1903 the first step was taken to abolish the circle system as it prevented the expansion and popularity of the notes The five rupee note was made universal legal tender except in Burma and this restriction was removed in 1909 Notes of the denomination of Rs 10 and Rs 50 were universalized in 1910, of Rs 100 in 1911 and the Chamberlain Commission recommended the universalization of Rs 500 note also This led to a rapid expansion of their circulation Facilities for encashment of notes were provided at Government treasuries in various places and the Presidency banks also provided such facilities During the War the uncovered issue was increased, but further development in their expansion ceased The Smith Committee recommended the abolition of war time restrictions and the provision of extra-legal facilities for their encashment to make them more popular

Paper Currency Reserve

The maximum fiduciary issue fixed by the Act of 1861 was rupees four crores and the limit was increased from time to time by special Acts It was raised to six crores in 1871, eight crores in 1890, ten crores in 1897 and twelve crores in 1905 Up to that time the securities were the rupee securities of the Government of India held in India The Act of 1905 authorised the holding of sterling securities in England up to two crores Since 1905 a part of the invested portion had been in sterling securities In 1911 the security reserve was raised to 14 crores, four crores of which were to be in sterling securities

Up to 1898 the whole of the metallic reserve was held in silver coin in India, but according to the Gold Note Act of 1898 the Government could keep any portion of the metallic reserve in gold coin and the Act of 1900 gave power to hold a part of this gold coin in London The Act of 1905 authorized the Government to hold the metallic reserve or any portion of it

in London or India and in gold coin or bullion or in rupees or silver bullion All the rupee coin was to be held in India only As the note issue gradually expanded, an ever-diminishing portion came to be invested and the proportion of the liquid reserve increased to 80 to 85 per cent The reason was that the liquid portion of the reserve was used to support exchange whenever necessary and this was the first line of defence of the currency system This was at the cost of economy and the proportional reserve system would have served the purpose better

Criticism of the pre-war composition of the Paper Currency Reserve

(i) The metallic reserve was unduly large

(ii) It was impossible to increase the fiduciary issue except by resort to legislation

(iii) A part of the Paper Currency Reserve was invested in sterling securities in England The first two conditions made the system inelastic The reason for maintaining a part of the fiduciary portion in sterling securities was that they were useful and that they were not likely to depreciate in value The arguments against the provision were that the maintenance of the exchange value of the rupee was not the proper function of the Paper Currency Reserve which ought to have been to ensure the convertibility of notes and that sterling securities also could depreciate in a crisis in England Public confidence could be secured by keeping the whole of the Reserve in India

Note issue was entirely dissociated from banking and there was the Treasury system and large sums were locked up in Government Treasuries producing a stringency in the money market during the busy season

The internal currency was inelastic and it could not be expanded except by importing funds from abroad by purchasing Council Bills or by importing sovereigns The cheque system was not and is not even now much in use in India to relieve the monetary stringency In other countries special temporary issue of paper currency is made against commercial bills of exchange and by placing Government funds at the disposal of a Central Bank The Smith Committee had recommended the issue of emergency currency to the Imperial Bank against 90 days' bills and when in 1921 the Reserve Treasury system was abolished in India, Government funds were placed at the disposal of the Imperial Bank which began to act as the Government Bank

The Chamberlain Commission had recommended that the fiduciary reserve should be fixed at the amount of notes held by the Government in the Reserve Treasuries *plus* one-third of the note circulation The Smith Committee recommended

that the metallic portion should not fall below a minimum percentage of the note issue and the proportion suggested was 40 per cent though they emphasized the necessity of keeping a substantial margin above the statutory minimum during the busy season These measures were recommended to remove the inelasticity of the currency in this country In both cases the fiduciary reserve would increase automatically with the increase in circulation and resort to legislation would become unnecessary The Government accepted the suggestion of the Smith Committee and fixed a minimum of 50 per cent

EFFECTS OF THE WAR

In the beginning there was a great run on the Currency Offices for the conversion of notes and in the first eight months of the War, notes of the value of Rs 10 crores were returned, but as confidence revived the note circulation increased After March 1915 the effects may be summarised as below —

(1) Paper currency was inflated to a great extent owing to increased demand for currency

(2) The fiduciary issue increased from 14 crores in 1911 to 120 crores in 1919 by various Acts and permanent and temporary investments gradually increased to 20 crores and 100 crores respectively This was because the Government experienced a great difficulty in finding enough coin to be held in the reserve and hence the increase in the invested portion The Government incurred in India a huge expenditure on behalf of His Majesty's Government and on behalf of the Dominions The recovery of this expenditure was made in London by the Secretary of State and investments were made in the British Treasury Bills or short-term sterling securities

(3) The metallic reserve fell from 78 9 per cent in 1914 to 35 8 per cent in 1919

(4) Notes of the denomination of Re 1 and Rs 2½ were issued in December 1917 and January 1918 respectively

(5) Extra-legal facilities for encashment of notes were abolished owing to the scarcity of rupees and, therefore, notes were at a discount in some places These facilities were restored in 1920-21

(6) 200 million ounces of American silver released under the Pittman Act were imported into India to meet the Paper Currency crisis of April 1918

In September 1919, by the temporary amendment of the Paper Currency Act, the maximum limit to which the Currency Reserve could be invested was raised to 120 crores and 100 crores had to be invested out of it in the British Treasury Bills In March, 1920, these provisions were extended for another six months The restrictions with regard to the location of the

reserves and their rupee or sterling character were abolished There was a great demand for remittances to London and it was not possible to meet it from the cash balances of the Secretary of State Sterling securities held in the Paper Currency Reserve in London had to be sold to meet it This meant the withdrawal and cancellation of currency notes in India at the rate of Rs 15 to £1 to the extent of the rupee value at which the sterling securities were held in the Reserve

On October 1 1921, the Indian Paper Currency Amendment Act was passed whose provisions were as given below —

(a) *Permanent provisions*

(i) The metallic reserve was to be at least 50 per cent of the total reserve The Babington-Smith Committee had recommended 40 per cent

(ii) Barring Rs 20 crores worth of securities held in India, the remainder were to be held in England and were to be short-term securities of a duration of not more than 12 months This was in accordance with the suggestions of the Smith Committee

(iii) Emergency currency could be created by a loan to the Imperial Bank from the Paper Currency Reserve to the extent of Rs 5 crores which limit was raised to Rs 12 crores in 1923 against 90 days bills of exchange at 8 per cent

(iv) The Secretary of State was not to hold more than five million pounds in gold bullion in London

(b) *Temporary provisions*

(i) The invested portion for the time being was fixed at 85 crores

(ii) Rupee securities known as *ad hoc* securities were created by the Government which were to be gradually replaced by sterling securities The funds for purchasing the latter securities were not available in large quantities The income from the following sources was to be paid down into the Paper Currency Reserve to reduce the created rupee securities as were above the permissible figure of Rs 12 crores —

(1) Interest derived from the securities in the Paper Currency Reserve

(2) profits on the fresh coinage of rupees,

(3) interest on the Gold Standard Reserve when it exceeded £40 million and

(4) interest on commercial bills of exchange deposited with the Controller of Currency

These were the sources of income which were diverted to reserve except in 1921-22 when the excess in the Gold Standard Reserve was used to cancel *ad hoc* securities

On April 1, 1927, the gold and sterling securities in the Paper Currency Reserve were revalued at Rs 13-1-3 to the sovereign in accordance with the provisions of the Indian Currency Act of 1927. From 1920 till 1927 they were valued at Rs 10 to the sovereign. The result was an increase of Rs 9.30 crores in the holding of gold and sterling securities. This was used to cancel an equivalent amount of Indian Treasury Bills.

The composition and location of the Paper Currency Reserve from 1925 to 1930 is shown in the following table —

(*In crores of rupees.*)

On 31st March	Gross Circulation	Silver coin in India	Gold coin and bullion in India	Silver bullion under coinage	Securities: Rupee in India	Securities: Sterling in England	Internal Bills of Exchange	Percentage of securities to total Reserve
1925	184.1	70.2	22.3	6.7	57.1	20.1	8.0	10.8
1926	193.3	77.2	22.3	7.6	57.1	29.0		11.6
1927	181.1	95.9	22.3	8.5	19.7	5.5	2.0	31.1
1928	181.8	98.7	29.7	7.6	37.9	5.7	7.0	26.4
1929	188.0	91.9	32.2	1.9	13.2	10.6	2.0	28.7
1930	177.2	108.1	32.2	2.9	33.9	0.1		
1931	160.9	117.9	25.9	7.0	10.1			

The composition of the Currency Reserve held against the note circulation at the end of each month —

(*In lakhs of rupees.*)

Month	Gross circulation of notes	Coin and Bullion Reserve: Silver coin in India	Coin and Bullion Reserve: Gold bullion in India	Coin and Bullion Reserve: Silver bullion in India	Securities: Rupee securities in India	Securities: Internal Bills of Exchange
1931						
March	1,60,84	1,17,86	25,85	6,91	10,19	
April	1,60,11	1,18,20	27,51	7,20	7,20	
May	1,51,79	1,19,61	20,21	7,83	7,11	
June	1,52,51	1,22,11	17,14	7,39	5,37	
July	1,55,65	1,25,66	16,56	6,90	6,53	
August	1,53,58	1,26,91	12,37	5,11	9,16	
September	1,48,71	1,26,81	4,21	5,73	9,19	2,50
October	1,50,75	1,21,65	1,30	6,92	23,88	
November	1,62,36	1,21,61	4,18	7,75	28,52	
December	1,70,30	1,15,05	1,56	7,94	49,25	2,50
1932						
January	1,79,16	1,08,88	4,83	6,95	55,00	3,50
February	1,79,54	1,04,12	4,92	8,09	59,41	3,00
March ..	1,78,11	1,01,96	5,26	9,23	57,94	3,75

(*Indian Year Book*, 1933, p. 877.)

Gross and Active Circulation of Notes

Gross circulation means the value of all notes that have been issued, but have not been paid off. It diminishes usually in the busy season because the Imperial Bank and the Government Treasuries send their notes for encashment to the Paper Currency Offices when cash is required for moving the crops.

Active circulation is the amount of notes issued *minus* those held in Government Treasuries and local head offices of the Imperial Bank of India. It increases in the busy season because notes are used in meeting the seasonal demand side by side with cash.

The Gold Standard Reserve

The creation of a gold reserve was recommended by the Fowler Committee and the profits on the coinage of rupees were to be set apart and kept in gold as a special reserve in India. The Committee wrote: "We also recommend that any profit on the coinage of rupees should not be credited to the revenue or held as a portion of the ordinary balances of the Government of India but should be kept in gold as a special reserve entirely apart from the Paper Currency Reserve and the ordinary Treasury balances." The use of this reserve as suggested by them was that it should be freely available for foreign remittance whenever the exchange falls below specie point, and the Government of India should make its gold available for the purpose, when necessary, under such conditions as the circumstances of the time may render desirable. For example, the Government of India might, if the exchange showed a tendency to fall below specie point, remit to England a portion of the gold which it may hold, a corresponding reduction being made in the drawings of the Secretary of State; and when it has accumulated a sufficient gold reserve, and so long as gold is available in its Treasury, it might discharge its obligations in India in gold instead of rupees.

Thus its principal use was to maintain the external value of the rupee and to prevent it from falling below the specie point in case of an adverse balance of trade. Under such circumstances gold was to be made freely available for foreign remittance purposes. This gold was to be kept in India. It was for the first time created in 1900 when coinage of rupees was undertaken.

As soon as this Reserve was established the profits on rupee coinage were sent to London and invested in securities there. The Fowler Committee had recommended that it should be kept in India but it was taken to England. In case of an unfavourable balance, the Secretary of State stopped selling Council Bills in London which prevented any addition to the

rupee circulation in India and for his various needs the Secretary of State could utilize this Reserve At the same time Reverse Councils would be sold in India on London which would mean withdrawing of rupees from circulation in payment of these Reverse Councils Both these measures would bring about a rise in the value of the rupee

At the same time India's unfavourable balance would also be liquidated The payment of these bills would be made from the Gold Standard Reserve by the Secretary of State It could also be utilized to meet the Home Charges, because when the device of Council Bills in the event of an unfavourable balance of trade would not be available, the Secretary of State would meet the Home Charges from the Gold Standard Reserve.

AMOUNT, COMPOSITION AND LOCATION OF THE RESERVE

As has already been noticed the Secretary of State decided that the profits of rupee coinage should be remitted to London and invested in sterling securities and this policy was pursued thereafter In 1906 a slight change was introduced To meet the sudden demand for rupees a special reserve was created in India outside the Paper Currency Reserve It was to be a part of the profits on rupee coinage and was to be in the form of coined rupees

There were thus two branches of the gold reserve one in London and the other in India in the form of rupees This Reserve was called the Gold Standard Reserve As already noted the Mackay Committee recommended that £ 1 million of the Gold Standard Reserve should be utilized for railway capital expenditure and in spite of protests from the Government of India and the Indian commercial community, the Secretary of State actually diverted £ 1,123,000 on railway capital expenditure The Secretary of State changed his decision in 1907-08 when the Gold Standard Reserve was hit very hard by the crisis and £ 8,058,000 was withdrawn to meet Reverse Councils

The Government of India, in their despatch of 1st April, 1909, pleaded for a larger holding of the Gold Standard Reserve and considered that the minimum amount in the Reserve should be £ 25 million, apart from the gold in the Paper Currency Reserve and Treasuries and till that limit was reached, the profits of rupee coinage were not to be diverted to capital expenditure on railways They also maintained that a substantial part of it should be in a liquid form and not in securities and also urged the importance of holding a large amount in India The Secretary of State agreed to the minimum amount, but he did not agree to keep a large part in a liquid form and only £ 1 million was to be kept in a liquid form on short loans and in Bank Deposits

Composition of Gold Standard Reserve on 31st March, 191[illegible] :—

	£
Gold at the Bank of England	[illegible]
Silver in India [illegible]	[illegible]
Securities	[illegible]
Money at short notice	[illegible]
Total	[illegible]

RECOMMENDATIONS OF THE CHAMBERLAIN COMMISSION

As regards its amount the Commission pointed out that it was required to meet the demand [illegible] to unfavourable balance of trade and therefore its amount depended upon the growth of India's trade and the extent of deficiency that would be produced by unfavourable conditions. In the crisis of 1907-08 imports, ordered in advance in times of prosperity, continued to pour into India and adverse conditions were further accentuated. Of course, balance could restore itself even at such time but exchange would collapse in the interval. The Commission wrote "It is to maintain exchange in the interval before the balance of trade can right itself that the Reserve exists, and its resources must be sufficiently liquid to be used at once and sufficiently large to meet the most prolonged strain to which it may reasonably be anticipated that they might be exposed."

No hypothetical limit beyond which additions to the Reserve were to cease was, however, laid down, but the opinion was expressed that the suggested limit of £25,000,000 was not adequate and that all the profits of rupee coinage should be credited to the Reserve.

As regards its composition their recommendations were as below :—

(1) A much larger portion than the suggested total should be held in actual gold. In case of an exchange crisis in India large scale conversion of securities would mean a fall in their value and consequently a great loss would be caused and if, in addition, there was a crisis in London, the loss would be very severe. Hence they wrote that India should be independent of London in this respect as far as possible.

(2) A total of about £10,000,000 in gold could be secured at once by an exchange of assets between the Gold Standard Reserve and the Paper Currency Reserve. This total should be raised to £15,000,000 and thereafter the aim should be to keep one half of the Reserve in gold.

(3) The Silver Branch of the Gold Standard Reserve held in India was to be abolished and the rupees were to be handed over to the Paper Currency Reserve in exchange for gold.

As regards the location of the Reserve the majority held London is the most suitable place for it. They pointed out that "London is the clearing house of the world. India's chief customer is the United Kingdom, and London is the place where money is required both for the expenditure of the Secretary of State on India's behalf and for payment of India's commercial obligations to this country and the world in general. If the Reserve were kept in India it would have to be shipped to London to be used. This would involve delay at a moment when immediate action is essential."

The silver branch of the Gold Standard Reserve was abolished in 1915 and during and after the War the Reserve was largely held in sterling securities.

The following table gives the composition of the Reserve between 1913 and 1919 :—

(£ *Millions*.)

	1913 March	1917 March	1919 Nov. 30
Metallic Portion—			
Gold: In India		1	
In London	1½		
Silver in India	1		
Invested Portion—			
Securities	16	25	37½
Money at short notice	1	6	
Total	22½	32	37½

RECOMMENDATIONS OF THE BABINGTON-SMITH COMMITTEE

The Committee did not favour any maximum limit for they held that in the event of a sudden fall in prices, Indian trade might be adversely affected and a heavier call made on the resources for supporting the exchange than in the past.

(1) The profits of rupee coinage were to be credited entirely to the Reserve.

(2) The Reserve should contain a considerable proportion of gold. But as conditions of obtaining gold were not favourable and gold was required to a great extent to support notes, the Committee recommended that the Reserve should be kept as liquid as possible by holding securities with early dates of maturity. The aim should be to hold all the invested portion of the Reserve in securities issued by governments within the British Empire, other than the Government of India, and having a fixed date of maturity of not more than 12 months.

(3) A portion of the Reserve should be held in India to secure confidence, but the gold holding should not exceed one-half of the total and it should be made available only for export purposes

(4) The sterling investments of the Reserve should continue to be held in London

In 1920, the Government sold £55,382,000 of Reverse Councils which were paid in London out of the proceeds of the sale of sterling Securities and Treasury Bills in the Paper Currency Reserve In 1921 the interest on the securities in the two Reserves was decided to be utilized for reducing *ad hoc* securities in the Paper Currency Reserve On 30th September 1921, the Reserve exceeded £40 million In July 1923 it was decided that £20 million should be in securities not exceeding 2 years' maturity, £10 million in securities not exceeding 10 years, and £10 million in securities not exceeding 5 years' maturity

On 31st July 1925, its composition was as below —

Location	Amount. £
In England—	
British Government Securities	40,119,244
Cash at the Bank of England	514
Total	40,119,758

RECOMMENDATIONS OF THE HILTON-YOUNG COMMISSION

The Commission pointed out the following defects in connection with the Gold Standard Reserve —

(1) There was no clear line of demarcation between the purposes for which the reserves were to be used

(2) Besides, the amount of the Gold Standard Reserve and the time and manner of its use were wholly within the discretion of the Government The Gold Standard Reserve being built out of the profits of coinage the amount actually carried to the reserve depended on the price at which the silver was purchased and not upon the liabilities outstanding Any estimate of the amount of the outstanding rupee circulation was largely conjectural it might be estimated at 350 to 400 crores against which the reserve held at present was only $53\frac{1}{3}$ crores It was true that a portion of the reserve against the silver rupee was carried in the coin itself (in the shape of its bullion value) but it was admittedly difficult to make any immediate use of the metallic contents of the silver rupees at the time when those rupees were seeking conversion into sterling (Para 15, pages 7 and 8 of the *Report*)

The Commission, therefore, recommended the unification of the Paper Currency and the Gold Standard Reserves and proposed that the proportion and composition of the combined Reserve should be fixed by statute

The constitution of the combined Reserve recommended was as below —

(a) The liabilities of the Bank were to consist of Rs 185 crores of notes issued and Rs 50 crores was to be set aside as provision against conversion of hoarded rupees into gold

(b) The assets of the Bank were to consist of—

(1) Gold and gold securities to be at least 40 per cent of the liabilities but gold was ultimately to be 25 per cent of the liabilities and this limit was to be attained in 10 years, with a minimum of 30 crores

(2) Rupee securities should not exceed 25 per cent of liabilities with a minimum of 50 crores

(3) A reasonable amount of rupees should be kept by the Bank to meet the wants of the public, though no statutory obligation was imposed upon the Bank to convert its own notes into rupees

Recommendations of the London Committee

(See Chapter on 'Reserve Bank', pages 190, 191 and pages 253, 254 of this Chapter)

Recommendations of the Reserve Bank Select Committee

(1) The minimum gold holding in the Issue Department should be raised to Rs 40 crores The Bill provided for Rs 35 crores only The existing Reserve with the Government is Rs 41½ crores

(2) For silver securities the minimum of Rs 50 crores is accepted as provided in the Bill, but this is to be raised gradually by Rs 10 crores subject to the sanction of the Governor General

Sir George Schuster and Mr Taylor in a note accepted the minimum of Rs 40 crores of gold reserves, but held that the statutory provision should not be so framed as to hamper the discretion of the Bank to utilize its currency reserves in a manner that was most effective for maintaining the stability of the currency

Details of the Balance of the Gold Standard Reserve on the 31st March, 1932

	£
In England—	
Estimated value on the 31st March 1932 of the sterling securities of the nominal value of 10 570,000 (as per details below)	10 691,637
Gold { In England	2 152,334
Gold { In India	27,153,000
Cash at the Bank of England	29
Total	40,000,000

Details of Investments	Face Value. £
British Treasury Bills	4 220,000
Treasury 4 per cent Bonds 1931-33	850,000
Treasury 4½ per cent Bonds, 1932-34	1,250,000
Treasury 5 per cent Bonds 1933-35	2,500,000
Treasury 4 per cent Bonds, 1934-36	250,000
War Loan 5 per cent 1929 47 stock	1,500 000
Total	10 570 000

(*Indian Year Book*, 1933, page 878)

Council Bills and Reverse Councils

The system of Council Bills and Reverse Councils was an important part of the Gold Exchange Standard system during the pre-war period The Government were never bound by law to sell Reverse Councils or sterling bills and occasions for selling them have been comparatively scarce Council Bills or rupee bills were sold by the Secretary of State in London to banks which had to remit money to India The Secretary of State obtained funds in London in sterling This practice dated from the time of the East India Company and up to 1893 the sale of Council Drafts was limited usually to the actual requirements of the Secretary of State for meeting the Home Charges The Secretary of State could obtain funds at the most favourable rates in this manner and the system provided convenient means of settling a part of the debts due to India from foreigners on account of the excess of exports over imports from India The existence of this surplus in normal times made the system of Council Bills and Drafts possible

For some years after 1893 their sales were stopped to force up the exchange value of the rupee and thus a negative use of them was made Rupees were thus less freely available and their value in sterling went up According to Act II of 1898

Council Drafts were sold against gold set aside at the Bank of England as part of the Indian Paper Currency Reserve and in India notes were issued to meet the Council Bills. The object was not merely to obtain funds from India to meet the Home Charges, but also to expand currency in India. Later on, gold obtained in London by the sale of Council Bills was made available for purchasing silver to be coined in India. Since 1904 the offer of Council Bills was kept standing. Council Drafts were also sold in 1905 and 1906 to attract sovereigns to England which would have been sent from Egypt and Australia to India. In 1909 and 1910 they were freely sold to get gold in London in place of the large quantities of rupees which had accumulated in the Gold Standard Reserve in India through the sales of Reverse Councils in London during the crisis. Thus the Gold Standard Reserve Fund was taken back to London. The objects of Council Bills became wider and they became a part and parcel of the Government policy regarding finance, currency and exchange.

They were sold in London on Wednesdays to the highest bidders subject to a minimum price. On intermediate days, Intermediate or Special Bills were sold at a somewhat higher rate.

Reverse Councils were sterling bills sold in India upon the Secretary of State. They were sold in the crisis of 1907 to provide funds to the importers in India.

CRITICISM OF THE COUNCIL DRAFTS SYSTEM

(1) Unnecessarily large amounts were drawn from India to London, specially since 1904. It was defended on the ground that the Secretary of State was enabled to strengthen his financial position, but why it was necessary to strengthen the financial position was never explained. It was pointed out that by drawing more money than was immediately required by the Secretary of State, a reduction of debt was made possible. These excessive drawings made possible surplus budgets in India and the proper thing should have been to reduce taxation than to avoid debts.

(2) Superfluous money was lent in London at very low rates of interest to 'approved' borrowers whose list was maintained by the Secretary of State. Complaints were often made that favouritism was shown in the administration of these loans.

(3) Council Bills were often sold at rates below the specie-import point even when funds were not urgently required in London.

The system was justified on the ground that it was a great help to the foreign trade of India. On the other hand, it is

pointed out that trade could have taken care of itself and this has been so whenever for some reason their sales have been temporarily stopped. Thus there was no reason why the Government should have gone out of their way to assist trade in this manner. They ought to have made gold freely available for export whenever required.

The Chamberlain Commission pointed out that the sale of Council Drafts mitigated the seasonal monetary stringency in India. The demand for money arose in the first instance from the necessity of financing the crops up country according to the Commission, but the Council Drafts were taken only when the produce was ready for export. Thus there was an important period during which the needs of the market were not met by this system. The Commission remarked: "It is obvious that the sales of Council Drafts are affected by circumstances quite independent of the Indian money market; a high bank rate in London, for instance, or the holding back of produce in India for higher prices may result in the demand for Council Drafts being slack in the busy season, while revenue collections are as heavy as ever. In this case the money so collected accumulates in the Reserve treasuries and remains locked up there." Thus Indian money was lent in the London money market and it was locked up in the Government treasuries in India in times of scarcity.

System of Government Purchase of Sterling

In 1923-24 the sales of Intermediate Councils at higher rates were stopped and were replaced by the purchase of sterling in India from banks and private financial houses who were willing to sell their sterling resources in London for the offer of rupees to them in India. This was done by the Government through the agency of the Imperial Bank. In 1924-25 the system was further extended and the sterling purchase system was the principal mode of remittance. Since 1925-26 the Council Drafts system has been replaced by the sterling purchase system in India.

In response to the recommendations of the Hilton-Young Commission the system of purchase in India by public tender was introduced since April 1927. On Wednesday tenders are received in Calcutta, Bombay, Madras and Karachi and particulars of the amounts allotted at each rate are published in each of these places on the following day. Intermediates also are offered at the offices of the Imperial Bank at these places at a rate 1/32*d* above the highest rate accepted on the previous day on which tenders have been received. The Government can take advantage of the rising exchange and the appreciation of the rupee is prevented above the point fixed by the Government. Immediate course of exchange can be

accurately judged and purchases can be regulated with reference to market conditions in India Violent fluctuations can be avoided with advantage to trade The exchange banks need not discount their bills in London as they can get funds in India by selling sterling bills to the Government and the system, therefore, is very suitable from their point of view

DISADVANTAGES OF THE SYSTEM

(1) The Government can increase their magnitude to such an extent that free flow of gold into India may be prevented unless they sell such bills for their requirements only

(2) Foreign centres dealing with India are placed at a disadvantage When Council Bills were sold in London, the international financial centre, foreign countries could easily compete in purchasing drafts on India That cannot be done under the sterling purchase system in India and the Government is prevented from obtaining the best possible price for the rupee These evils will be avoided when the Reserve Bank is established in India and entrusted with the remittance business of the Government to the Secretary of State and with maintaining the stability of exchange

CHAPTER XIX

Case for Devaluation

THE controversy regarding the ratio was started even before the present economic depression and the disastrous fall of gold prices, breakdown of the gold standard and the universal depreciation of the old currencies. Sir Purshottamdas Thakurdas in his *Minute of Dissent* to the Report of the Royal Commission on Indian Currency and Finance of 1926 had made out an unanswerable case for the 16*d.* ratio. The ratio controversy became a much debated issue after 1927. Indian businessmen on the one side and the official apologists on the other have been waging an endless controversy on the unsuitability of the 1*s.* 6*d.* (gold) ratio. The official case as presented by Sir George Schuster has been that an increase of exports and other economic indices denote a healthy economic progress of the country. The conclusion was drawn that if deflation of currency and exchange stabilization at 1*s.* 6*d.* (gold) ratio were really detrimental to the economic interests of the country, they would have been reflected in a reduction in exports. Indian businessmen and the nationalist economists did not agree with the view that the figures of export trade alone should provide the justification of the higher ratio. It has been pointed out that "the exports of the country must continue from the country as long as there are crops growing and the surplus crops can find outlet only through exports, for industrialized agriculture does not exist in this country." Most of the economic ills of the country have been attributed to the 18*d.* ratio by the pessimists, while the optimists have held that the travails of the industrialists were after all necessary to a period of adjustment. Indian businessmen consider the deflationary policy and exchange stabilization as responsible for the gloomy economic situation. They point to the heavy costs needed to maintain the new ratio and hold that the case for the new ratio is not commensurate with the costs involved. The drastic fall in prices and the consequent dislocation of the economic machinery of the country naturally riveted the attention of the public to the disastrous consequences of the exchange stabilization policy of the Government. A country-wide agitation was started to lower the exchange ratio when the Reserve Bank Bill was being framed, but all such efforts came to nothing.

MEANING OF DEVALUATION

Deflation, reflation, devaluation and inflation are some of the current terms of currency which need not be considered

in this Chapter in detail Monetary experts have suggested deflation and devaluation for currency stabilization Deflation may be called as a forcible reduction in the price-level by contracting the volume of currency so as to raise the value of currency unit in gold or in terms of goods 'devaluation is a return to the gold standard sacrificing the pre-War par of exchange and establishing a different and a lower one—likewise the internal valuation of the currency might be allowed to depreciate' Several arguments have been advanced for securing improvement in trade, rise in prices of primary products, revival of industrial activity and promotion of economic progress It is held that devaluation can secure these advantages in the case of India

The Example of Other Countries

Most of the other countries have devaluated their currencies during the course of the economic depression The following table[1] shows the percentage of depreciation among the countries belonging to the Sterling bloc —

Name of the Country	Percentage of Depreciation
New Zealand	50
Australia	50
Great Britain	35
Canada	30
India	21

The classical illustration in this direction is the example of the French Franc of 1928 The depreciation of currencies in Japan and the United States of America should also be taken into consideration The imports from the former country are literally flooding the Indian market The Indian Tariff Board of 1932 in their Report regarding the grant of protection to the Cotton Textile Industry point out that "with currencies divorced from the gold standard in the principal countries concerned, there is a serious risk of unexpected developments occurring which may seriously react on the level of prices "[2] The Board are of opinion that if in this respect "developments occur which to any substantial extent falsify the tentative conclusions we have formed, there should be no hesitation to put in operation the provision for offsetting duties '

[1] See Rau's article 'Should We Unsettle the Settled Ratio?' in March 1934 Number of the *Mysore Economic Journal*

[2] Report of the Tariff Board 1932, regarding the Grant of Protection to the Cotton Textile Industry page 189, para 199

[3] *Ibid* , page 191, para 201

Let us see how India has fared in comparison with other countries, specially the agricultural countries, which have not only abandoned the gold standard, but have also devaluated their currencies

Percentage Decline in Import and Export Dollar Values since 1929[4]

Country	Imports 1930	Imports 1931	Imports 1932	Exports 1930	Exports 1931	Exports 1932
	%	%	%	%	%	%
Argentine	25	57	74	43	53	64
Australia	35	72	74	29	47	55
Canada	22	53	69	26	49	60
U S A	28	52	69	27	54	69
New Zealand	12	53	66	21	46	58
India	25	49	61	22	53	70
Norway	1	25	57	9	43	49
Denmark	3	23	55	6	27	53

India's imports have declined the least and her exports have declined the most It is not suggested that the depreciation of the foreign exchanges is the *only cause* of this state of affairs, but it cannot be gainsaid that it is a *very important cause* of this situation

The percentage share of the world's trade of some of these countries may be compared with that of India[5]

	1929 Imports	1929 Exports	1932 Imports	1932 Exports
Australia	1 98	1 79	1 35	2 10
Canada	3 65	3 71	2 87	3 83
Argentine	2 30	2 74	1 55	2 59
India	2 54	3 54	2 53	2 79

The percentage share of the import trade of all countries excepting India has decreased The share of the export trade of Canada and Australia has expanded, but that of India has declined very much

The following two tables show that there was a tendency for a rise in prices from the date of depreciation of currency and official suspension of gold standard in various countries of the world[6] —

[4] League of Nations, *World Economic Survey*, 1932–33, page 214

[5] *Ibid* , page 218

[6] *Ibid* , pages 222 and 323

INDEX-NUMBERS OF WHOLESALE PRICES
(Base 1913, 100)

Country	1930 Average	1931 Average	1932 June	1933 January	February	March	April	May	June	July
Argentine	122	118	119	113	113	112	112	112	113	
Australia	147	131	128	123	122	122	125	129		
Canada	135	113	104	100	99	101	102	105	106	110
U S A	124	105	92	87	86	86	86	90	93	
Japan	137	116	111	140	136	134	133	134	136	138
New Zealand	143	133	129	125	130	129	129	130	130	
Denmark	130	111	113	117	124	123	122	123	123	125
United Kingdom	119	104	98	100	99	98	97	99	102	102
India	116	96	86	88	86	82	84	87	89	91

THE ABANDONMENT OF THE GOLD STANDARD

Date of depreciation in relation to gold: Year Month	Country	Official suspension of gold standard	Official imposition of exchange control
(Countries whose Currencies have depreciated in relation to Gold)			
1929 Nov	Argentine	Dec 16 1929	Oct 10 1931
1930 March	Australia	Dec 17 1929	
1931 Sept	Canada	Oct 19 1931	
1933 April	U S A	March 6 1933	March 6 1933
1931 Dec	Japan	Dec 13 1931	July 1 1932
1930 April	New Zealand	Jan 1 1932	
1931 Sept	Denmark	Sept 29 1931	Nov 18 1931
1931 Sept	United Kingdom	Sept 21 1931	
1931 Sept	India	Sept 21 1931	

Comment is needless as the tables are self-explanatory As the Indian currency remained over-valued in terms of sterling, the indirect effect on wholesale prices as shown by the indices has been towards a fall This is not the case with other countries where a tendency to rise is shown approximately, roughly though, from the date of depreciation of the currency and suspension of the gold standard

It may be argued that because our export trade has not expanded with a 33 per cent depreciation against gold, there is no guarantee that further depreciation of our currency in terms of Sterling will stimulate it The reason is easily understandable and this point has been very clearly explained by Mr Nalini Ranjan Sarker in the following words —

"As will be admitted by even those who are against devaluation at the present moment, Rupee was over-valued in

September 1931 when however, the linking of the Rupee with the depreciated Sterling gave us no doubt some comparative advantage as against non-British countries, though in relation to Sterling, Rupee has continued to be over-valued But along with India most of her great international customers have also gone off gold and depreciated their currencies and exchange to nearly the same extent Thus while the relative advantage of depreciation has been lost the original handicap of over-valuation still persists The depreciation of 33 per cent now remains only against gold countries, that advantage is no longer available against non-gold countries, and this latter group consists of countries to which about 75 per cent of our goods are exported '

The following table shows the value of India s foreign trade in 1932-33 with various countries grouped under the three broad divisions, Gold countries Sterlingaria, and other non gold countries —

DIRECTION OF INDIA S EXPORT TRADE IN 1932-33

	Value Rs
Gold Countries	27,13,92,588
Sterlingaria	67,27,26,306
Other Non Gold Countries	38,02,37 043
TOTAL	132,43 55,937

Thus the sterling bloc is the largest group of our export customers and devaluation is the most potent means of getting advantages in these markets

DEVALUATION AND RISE IN PRICE

It may be said that prices of agricultural products may not rise as a result of devaluation This view seems to be incorrect and other things being equal devaluation must bring about a rise in prices The following figures will prove that a rise in prices was brought about as a result of devaluation

INDEX OF PRICES

1931	Raw Jute	Jute Manufactured	Tea	Rice
June	45	67	64	74
July	44	65	72	76
August	46	68	65	76
September	51	69	63	73
October	62	80	68	77
November	60	83	75	76
December	58	87	68	78

[7] N R Sarker's statement on the Ratio Question in the *Mysore Economic Journal*, December 1933

Prices rose immediately when the Rupee was devaluated in terms of gold in September 1931. But the advantage has not been quite so well maintained just because even though the Rupee was devaluated in relation to gold, it remained over-valued in relation to Sterling at 18*d*. The steps taken by the Government in order to maintain this high exchange parity have further depressed prices. If along with the abandonment of the gold standard India had also devaluated the Rupee in terms of Sterling as some of the Dominions and even countries like Norway and Sweden which have linked their currencies with Sterling have done, greater rise in prices would have been achieved. This is just what we should now advocate in order to receive the benefits that the abandonment of gold standard was expected to confer upon us. The right way of putting it would be that the expected improvement either in prices or in our export trade in view of the 33$\frac{1}{3}$ per cent depreciation of the Rupee in terms of gold did not either materialise or continue on account of the fact that the Rupee was over-valued and that no steps were taken to devaluate it in terms of Sterling. *Devaluation in terms of Sterling also is essential to achieve an adequate rise in prices.* Our devaluation has been half-hearted; it stopped half way. *Let us push it further; reduce the value of the Rupee in terms of Sterling and we shall immediately witness a welcome rise in prices.*'

The fact that prices will rise as a result of devaluation is proved by the experience of other agricultural countries within the Sterling group when their currencies were devaluated in relation to Sterling since England abandoned the gold standard in September 1931.

HOME CHARGES

It is pointed out that at the 18*d*. ratio it will be easier to meet the Home Charges and other foreign obligations than at the lower ratio. At first sight it so appears that this argument is really correct, because more rupees will be required to meet the same amount of foreign obligations at 1s. 4*d*. than at 1s. 6*d*. In reality it is not so, though theoretically it may be correct. It is not enough merely to convert our foreign obligations or Home Charges at various rates of exchange and say that at a certain ratio it would be cheaper to repay them than at another ratio. One must go behind the mere arithmetical calculation and their annual or total value in terms of rupees. Ultimately we have to meet them out of our balance of trade, that is, out of our surplus of exports over imports. In the absence of a favourable trade balance, they must be met by exporting gold as is being done for the past two years. It would be of no use to reduce their burden artificially by maintaining the rupee at a higher value if the trade surplus, out of which ultimately even the smaller amount

of rupees must be found, is being reduced to a very great extent thereby The 18*d* ratio encourages imports, discourages exports which necessarily means a shrinkage in the favourable balance of trade On the other hand if the Rupee is devaluated exports are encouraged which necessarily means a larger favourable balance of trade out of which our foreign obligations can be met

"In the olden days when the Rupee was worth 16*d* India had bumping favourable balances of trade, and the Government found it so easy to repay their Home Charges The Home Charges never worried them And now when the rupee is 18*d* our trade balance has declined so dangerously that it is insufficient to meet them and we have therefore, had to export increased quantities of gold to make up the deficit During the last two years we have exported gold valued at the fabulous amount of 127 61 crores Quite a large part of it was distress gold which had to be parted with because the export of commodities could not be maintained "

It must be admitted that the depression is to a very great extent responsible for the fall in India s balance of trade, but at the same time it would be futile to deny that the devaluation of the Rupee would have stimulated exports, reduced imports helped India to obtain a much larger trade balance and facilitated the payment of our foreign obligations

Even before September 1931 the Government of India had to resort to the device of transfers through the Currency Reserves or that of borrowing funds in the London Money Market to enable the Secretary of State to meet the Home Charges The results have by no means been satisfactory Our monetary gold resources have been depleted currency has been contracted to a very great extent and our foreign obligations have been increased During the five years before 1931-32 the Government of India could hardly remit Rs 20 crores per annum on an average through the normal process as shown by the following table —

Remittances to the Secretary of State during the Years 1926-27 *to* 1931-32

(*In thousands of Rupees*)

Year	Net purchase of sterling	Sterling Loans	Transfers through Currency Reserves
1926–27	89 02		23 43 00
1927–28	37 77 30		5 06 00
1928–29	41 02 18	8 00 00	
1929–30	20 39 12	8 00,00	15 77 00
1930–31	48 82	5 32 00	11 63 00
TOTAL	99 58 80	21 32 00	55 89 00
1931–32	34 05 91		37 73 00

In 1931-32 also, when the Government could remit as much as Rs 34 crores, they could not purchase Sterling in the market until October of the same year and had to sell Rs 19 crores in order to maintain the exchange. As has been admitted even by the Controller of Currency in his Report for 1931-32, had it not been for the huge export of gold from India, the position would have been still worse.

It has to be admitted that devaluation would have affected the Government's financial position, but the *economic* interests of the country must always be given precedence over the financial conveniences of the Government. The financial troubles of the Government would largely depend for their solution on the improvement of economic conditions within the country, on a rise in the prices and on the purchasing power of the people.

During the last several years emergency taxation has been piled up to a very great extent and still the Government finds it very difficult to balance the budget. Increase in income-tax, surcharges and the levying of excise duties on sugar and matches have been resorted to to balance the budget. The budget estimates for 1934-35 show an anticipated surplus of Rs 1,29 lakhs only when nearly all emergency taxation proposals have been maintained and there have been new excise duties imposed on matches and sugar. The railway budget for 1934-35 discloses a net deficit of Rs 7¼ crores for 1933-34 and a fall in the income for 1933-34 to 85¾ crores as against the budgeted amount of 89½ crores. For 1934-35 the deficit is estimated at Rs 5¼ crores.

It does not mean that the high ratio is wholly responsible for this state of affairs, but it will be correct to say that it has accentuated the evil effects of trade depression and conditions might have been better if devaluation were practised.

Burden of Indebtedness

The burden of agricultural indebtedness has increased because of a fall in prices for which the 18*d* ratio is to a large extent responsible. The fall in exports has depressed the prices of agricultural produce inside the country also, but the burden of rent, land revenue and interest charges has not correspondingly diminished.

Devaluation and Consumer

In the arguments usually advanced in favour of the 18*d* ratio prominence is given to its benefits to the consumer. A little reflection will show the fallacy of the argument that the consumer is benefited by the 18*d* ratio. In reality society cannot be split up into separate consuming and producing

groups Nearly all consumers are directly or indirectly producers and if, therefore, they have to pay something more for imported goods which they purchase, they will be more than compensated by getting higher prices for what they produce Consumers are also wage-earners and as such they will be benefited in the form of better wages and full time employment under the regime of high prices Wage earners lose in a period of rising prices As consumers they get increased purchasing power in a period of trade prosperity "When you consider further that on the whole we produce more than we consume, and that the proportion of the necessities of life that have to be imported to that which can be found within the country is rather small, it would be clear that on the balance the country as a whole stands to gain from devaluation and the consequent rise in prices" In this connection, Sir Purushottamdas Thakurdas in his *Minute of Dissent* to the Royal Commission on Indian Currency and Finance, 1926, wrote that 'regarding imported articles, the benefit from a higher exchange is immediate, but the proportion of such benefit accruing to the masses is very small, estimates ranging between 7 per cent and 40 per cent of the imports' (Para 56 of the *Report*)

In some quarters it is pointed out that the country should not resort to *currency manipulation*, but wait for *better understanding between nations* This argument supposes that lowering the ratio to 16*d* would be currency manipulation In this respect any change can be called manipulation In this connection Mr N R Sarker in reply to Acharya Roy's statement pointed out that "it is a matter of common knowledge that the maintenance of the 18*d* Rupee is itself one of the greatest acts of currency manipulation in recent times It is universally admitted how money, volume of currency, transfer of funds from one reserve to another, in fact everything has been manipulated by the Government in their effort to maintain an over-valuated Rupee Ratio"

It is true that *better understanding between nations* to restore the price equilibria and currency systems is highly desirable, but to wait for it indefinitely would be a philosophy of despair It should be called economic fatalism Every country must do whatever it can to improve economic conditions and this is what other countries have done Japan, England, America, etc, did not wait for the rest of the world to intervene in their behalf and cure their economic ills They took steps which they thought best suitable for their countries India should also do the same thing There is no guarantee that if we wait we are sure of achieving better understanding between nations As a matter of fact the nations of the World did meet and held

the World Economic Conference in June 1933, but they dispersed without any substantial achievement to their credit According to Prof Gustav Cassel "other countries by no means need to remain entirely passive," and "there is nothing to prevent them individually proceeding on the right road and introducing a rise in their price level "

It is unfortunate that even the ratio question has been considered from the provincial point of view and it has been asserted that "the move for the devaluation of the Rupee is being taken to give indirect protection to the Bombay Millowners " If the 16*d* ratio would mean protection, it must be equally for all millowners, be they in Bombay, Ahmedabad, Nagpur, Sholapur, Cawnpore, Madras or Bengal It would give protection not only to millowners but to all producers who have to face foreign competition Businessmen throughout India have been demanding that the ratio should be lowered and it is not the Bombay millowners alone who have put forward that demand The Federation of Indian Chambers, consisting of varied Indian industrial and commercial interests, have passed unanimous resolutions demanding the 16*d* ratio

It was pointed out by Acharya Roy that "from the standpoint of Bengal industrial development specially in the line of textile, this devaluation move appears to be more sinister Bengal is forging ahead in the matter of industrial development, but if this move succeeds, it will increase the prices of machinery considerably and without importing which Bengal cannot do at present, and all hopes for industrial development will be doomed for ever "

Of course, the price of imported machinery would rise at the 16*d* ratio, but that would be applicable to Bombay and Bengal equally The disadvantage would be common to all importers of machinery in all provinces in India No doubt that province which imports machinery of a larger value will have a greater disadvantage because it will have to pay a larger total sum During the five years 1927 28 to 1931-32 the total value of textile machinery imported into Bengal and Bombay was Rs 92,93,167 and Rs 7,65,41,614 respectively Bombay should, therefore, lose more than Bengal in this case

If the starting of new mills is in the mind of those who advance this argument, it may be pointed out that nothing would prevent Bombay millowners from erecting their new mills in Bengal

Let us grant that a higher ratio will help Bengal by cheapening imported machinery Suppose Bengal starts a mill with a machinery worth Rs 10 lakhs at the 18*d* ratio The machinery may be expected to last for 10 years and to produce goods worth at least Rs 10 lakhs annually If the ratio were

16*d* the millowner would have to pay 12½ per cent on Rs 10 lakhs, or 1 25 lakhs more than at 18*d* But for ten years he would be enjoying a 12½ per cent protection on annual production of Rs 10 lakhs worth of goods, or Rs 1 25 lakhs every year In other words the disadvantage of the purchase of machinery under an 18*d* Rupee would be wiped out in the very first year and the protection of 12½ per cent would continue to benefit the industry for every succeeding year

At 18*d* along with the cheapening of the price of imported machinery, the price of imported cotton goods will also be lowered which will intensify foreign competition People would not care to invest money in future when at present they find international competition to be very severe The cheapness of machinery reduces the cost undoubtedly, but the advantage given by it in resisting foreign competition would be far outweighed by the protection given by a lower ratio to the goods produced by the machinery It is thus clear that the Bengal Bombay controversy in this case is futile

DEVALUATION AND SMALL INDUSTRIES

The slightly higher price that may have to be paid for machinery with a lower exchange would give protection to manufacturers of machinery and spare parts in India It would thus give employment to people who will be able to invest their money in small industries

It is devaluation in terms of sterling which is needed and devaluation in terms of gold will give us no advantage in our trade with Sterling bloc countries These facts should be clearly borne in mind in a consideration of the ratio question

APPENDIX

The Imperial Bank of India Amendment Act of 1934

IT has been recognized since the plan of setting up a Reserve Bank for India was first considered that, with the transfer to a Reserve Bank of the purely central banking functions which are at present performed by the Imperial Bank of India, the latter should be freed from some of the restrictions which were so far imposed upon it. Therefore when the Reserve Bank of India Bill of 1927 was introduced on January 11, 1927, there was also simultaneously introduced an Imperial Bank of India Act (1920) Amendment Bill which was designed to remove some of those restrictions and to modify the control of Government over the operations of the Bank.

The Imperial Bank of India Bill of 1927 was referred to a joint committee identical with that which examined the Reserve Bank Bill in that year, and that committee recommended certain amendments to remove defects in the administrative machinery of the Bank. These have been incorporated in the present Act which received the assent of the Governor-General on the 6th March, 1934 and which will come into force on such date as may be appointed by the Governor-General in Council.

The more important provisions and amendments of the Act are as follows —

(*a*) Section 10 of the Imperial Bank of India Act of 1920 has been replaced by another authorizing the Bank to enter into an agreement with the Reserve Bank of India to conduct Government business as agent of the Reserve Bank.

(*b*) Section 9 of the old Act has been repealed to remove the limitation on the business which the Bank may transact at its London office and to give specific powers to the Bank to open branches outside India, in London and elsewhere.

(*c*) Certain amendments have been made to give the Bank extended powers in regard to its internal business and to remove restrictions on the foreign exchange business which the Bank may transact. For instance, the Bank can advance and lend money and open cash credits upon the security of the shares of the Reserve Bank, upon debentures or other securities for money issued under the authority of any Act of a legislature established in British India by, or on behalf of a municipal board or committee or with the sanction of the Governor-General in Council, upon debentures or other securities for money issued under the authority of a Prince or chief of any State in India and debentures of companies

with limited liability whether registered in India or elsewhere subject to the directions of the Central Board It can also lend money and open cash credits upon the security of goods which are hypothecated to it as security for such advances, loans or credits, if so authorized by the special directions of the Central Board According to the Act of 1920 the Bank could not grant loans for more than *six months*, but the new Act allows it to make advances for *nine months* for financing seasonal agricultural operations It also allows the Bank to acquire and hold movable and immovable property as security for any loan or advance

(*d*) The Bank is now allowed to deal in the foreign exchange business To bring this into effect the necessary amendments have been made in Part I of Schedule I

The restriction that it could borrow money *in India only* for its business has been removed which means that the Bank can borrow money outside India also for its own business It can generally do all such matters and things as may be incidental to the transacting of the various kinds of business *including the foreign exchange business*

(*e*) Certain amendments have also been made in Part II of Schedule I In this part the kinds of business which the Bank is not allowed to transact are mentioned According to the Act of 1920, the Bank cannot make loans for more than six months It cannot also discount, buy, lend or advance money on the security of any negotiable security having at the date of the proposed transaction a longer period to run than six months According to the new Act the Bank shall be allowed to lend for *nine months* in certain cases and it shall be able to discount or lend money on the security of any negotiable security which is to run for *nine months* from the date of the transaction, but this will be only in case of bills drawn for financing seasonal agricultural operations

(*f*) *Provision relating to the Constitution of the Bank* The Central Board shall consist of the following directors, namely —

(1) the presidents and vice presidents of the Local Boards established under this new Act

(2) one person to be elected from amongst themselves by the members of each Local Board established by this Act,

(3) a Managing Director to be appointed by the Central Board for five years whose appointment may be continued by the Central Board for such further periods not exceeding five years in each case as the Board may think fit,

(4) such number of persons not exceeding two and not being officers of the Government as may be appointed by the Governor-General in Council They shall hold office for one year but may be re-nominated ,

(5) a Deputy Managing Director who shall be appointed by the Central Board ,

(6) the secretaries of the Local Boards , and

(7) if any Local Board is hereafter established under this Act, such number of persons to represent it as the Central Board may prescribe

The Deputy Managing Director and the secretaries of the Local Boards shall be at liberty to attend all meetings of the Central Board and to take part in its deliberations, but shall not be entitled to vote on any question arising at any meeting The Deputy Managing Director shall have the right to vote in the absence of the Managing Director The Governor-General in Council shall nominate an officer of Government to attend the meetings of the Central Board, and such officer shall be entitled to attend all meetings of the Central Board and to take part in its deliberations but shall not be entitled to vote on any question arising at any meeting According to Section 28 of the Act of 1920 the Controller of the Currency is an *ex officio* member of the Central Board of the Bank and four other members are nominated to the Board by the Governor-General in Council According to the new Act the Controller of the Currency will not be an *ex-officio* member of the Board and the Governor-General in Council will have the power to appoint not more than two members to the Central Board The control of the Government over the operations of the Bank is thus lessened

(*g*) Under Regulation 54 of the Act of 1920 the Governor-General in Council is entitled to require of the Central Board of the Bank any information touching the affairs of the Bank and the production of any documents of the Bank, and he may also require the publication of such statements of its assets and liabilities in such form and at such intervals as he thinks fit This power of the Governor General is removed under the new Act, because the relevant provision is that "the statement of the balance shall contain the particulars and shall be in the form required by Section 132 of the Indian Companies Act, 1913, and the provisions of Section 136 of the same Act shall apply to the Bank in like manner as they apply to a banking company " It may, however, be mentioned that the provision by which the Governor-General in Council may appoint auditors under Regulation 59 to examine and report on the accounts of the Bank has been retained

This means that the Governor-General in Council will be in a position to examine the affairs of the Bank in case of necessity

It is to be noted that this last provision may be necessary to make effective Section 45 of the Reserve Bank Act to the effect that the agreement between the Reserve Bank and the Imperial Bank shall be conditional on the maintenance of a sound financial position by the Imperial Bank

INDEX

2367 33—Printed at The Bangalore Press Lake View' Mysore Road Bangalore City by T Subramania Aiyar Superintendent